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Richard L. Daft

ORGANIZATION
THEORY & DESIGN

Thirteenth
Edition

Richard L. Daft

Vanderbilt University

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About the Author

Richard L. Daft, Ph.D., is the Brownlee O. Currey, Jr, Professor of Management and Principal Senior Lecturer in the Owen Graduate School of Management at Vanderbilt University. Professor Daft specializes in the study of organization theory and leadership. Professor Daft is a Fellow of the Academy of Management and has served on the editorial boards of *Academy of Management Journal, Administrative Science Quarterly,* and *Journal of Management Education*. He was the Associate Editor-in-Chief of *Organization Science* and served for three years as Associate Editor of *Administrative Science Quarterly.*

Professor Daft has authored or co-authored 14 books, including *The Executive and the Elephant: A Leader's Guide to Building Inner Excellence* (Jossey-Bass, 2010), *Building Management Skills: An Action-First Approach* (Cengage/South-Western, 2014), *Management* (Cengage/South-Western, 2018), *The Leadership Experience* (Cengage/South-Western, 2018), and *What to Study: Generating and Developing Research Questions* (Sage, 1982). He also published *Fusion Leadership: Unlocking the Subtle Forces That Change People and Organizations* (Berrett-Koehler, 2000) with Robert Lengel. He has authored dozens of scholarly articles, papers, and chapters. His work has been published in *Administrative Science Quarterly, Academy of Management Journal, Academy of Management Review, Organizational Dynamics, Strategic Management Journal, Journal of Management, Accounting Organizations and Society, Management Science, MIS Quarterly, California Management Review,* and *Organizational Behavior Teaching Review.* Professor Daft has been awarded several government research grants to pursue studies of organization design, organizational innovation and change, strategy implementation, and organizational information processing.

Professor Daft is also an active teacher and consultant. He has taught management, leadership, organizational change, organization theory, and organizational behavior. He has been involved in management development and consulting for many companies and government organizations, including the National Academy of Science, Oak Ridge National Laboratory, American Banking Association, AutoZone, Aegis Technology, Bridgestone, Bell Canada, Allstate Insurance, the National Transportation Research Board, the Tennessee Valley Authority (TVA), State Farm Insurance, Tenneco, the U.S. Air Force, the U.S. Army, Eli Lilly, Central Parking System, Entergy Sales and Service, Bristol-Myers Squibb, First American National Bank, and the Vanderbilt University Medical Center.

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Preface

My vision for the Thirteenth Edition of *Organization Theory and Design* is to integrate current organization design problems with significant ideas and theories in a way that is engaging and enjoyable for students. The biggest changes in the world of organizations are the emergence of large digital, platform-based organizations and the increasing focus in corporate America on the issues of social welfare and sustainability. A new chapter in this edition gives students the chance to learn about the design of dual-purpose organizations that combine profit-seeking and social welfare goals to provide self-sustaining social benefits to society. In addition, the chapter covering information technology has been completely revised to look at the exciting development of new platform-based digital organizations, including companies such as Uber, Airbnb, Facebook, and YouTube, and the increasing digitalization of traditional organizations. An important change to the Thirteenth Edition is a "Remember This" section at the end of each major section in a chapter that reviews the key ideas and concepts covered in that section. Other significant elements of this edition include "Managing by Design Questions" and "How Do You Fit the Design?" boxes, along with updates to every chapter that incorporate the most recent ideas, new case examples, new book reviews, and new end-of-book integrative cases. The research and theories in the field of organization studies are rich and insightful and will help students and managers understand their organizational world and solve real-life problems. My mission is to combine the concepts and models from organization theory with changing events in the real world to provide the most up-to-date view of organization design available.

Distinguishing Features of the Thirteenth Edition

Many students in a typical organization theory course do not have extensive work experience, especially at the middle and upper levels, where organization theory is most applicable. Moreover, word from the field is that many students today often do not read lengthy chapter opening examples or boxed examples, preferring instead to focus on chapter content. To engage students in the world of organizations, the Thirteenth Edition uses "Managing by Design Questions" at the start of each chapter. These questions immediately engage students in thinking and expressing their beliefs and opinions about organization design concepts. Another in-chapter feature, "How Do You Fit the Design?" engages students in how their personal style and approach will fit into an organization. Other experiential activities that engage students in applying chapter concepts include new "BookMarks," new "In Practice" examples, new end-of-chapter cases, and new integrative cases for student analysis. The total set of features substantially expands and improves the book's content and accessibility. These multiple pedagogical devices are used to enhance student involvement in text materials.

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New Chapters. Two chapters in the Thirteenth Edition contain virtually all new material. Chapter 7 introduces students to the design of a new organizational form called a dual-purpose or hybrid organization that combines profit-seeking and social welfare goals to provide self-sustaining social benefits to society. Chapter 7 also discusses the design issues associated with an increasing corporate focus on corporate social responsibility and sustainability. In addition, Chapter 9 (Chapter 8 in the previous edition) has been completely revised to explain the emerging platform-based organization form, including companies such as Facebook, YouTube, Uber, and Airbnb, and the increasing digitalization of traditional industrial organizations, such as GE and Siemens.

How Do You Fit the Design? The "How Do You Fit the Design?" feature presents a short questionnaire in each chapter about the student's own style and preferences, to quickly provide feedback about how they fit particular organizations or situations. For example, questionnaire topics include "What Is Your Cultural Intelligence?" "Your Strategy Strength," "How Sustainable Are You?" "Are You Ready to Fill an International Role?" "How Will You Handle Decentralization and Autonomy?" "Corporate Culture Preference," "Making Important Decisions," and "Personal Networking." These short feedback questionnaires connect the student's personal preferences to chapter material to heighten interest and show the relevance of chapter concepts.

Managing by Design Questions. Each chapter opens with three short opinion questions that engage students in clarifying their thoughts about upcoming material and concepts. These questions are based on the idea that when students express their opinions first, they are more open to and interested in receiving material that is relevant to the questions. Example questions, which ask students to agree or disagree, include:

A certain amount of conflict is good for an organization.
The best measures of business performance are financial.
Artificial intelligence is objective and bias-free compared to human decision making in organizations.
Platform-based organizations are a new form of organization, but the fundamental assumptions are the same as for a traditional industrial organization.
A CEO's top priority is to make sure the organization is designed correctly.
Managers should use the most objective, rational process possible when making a decision.

As a follow-up to the three "Managing by Design" questions, each chapter contains three "Assess Your Answer" inserts that allow students to compare their original opinions with the "correct" or most appropriate answers based on chapter concepts. Students learn whether their mental models and beliefs about organizations align with the world of organizations.

Opening Examples. Following the Managing by Design questions, each chapter's text begins with a brief, interesting example, often involving a problem or a sticky situation, that gets students thinking about how the chapter topics apply in the real world of organizations. Chapter 1 begins with a longer opening case about GE's successes and difficulties and the relevance of each chapter's content to GE's

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issues. Nine of the 14 chapters are introduced by new real-life examples, including Waymo's self-driving cars, the U.S. Marine Corps Rifle Squads, Patagonia, and the Coca-Cola Company.

BookMarks. "BookMarks" are short book reviews that reflect current issues of concern for managers working in real-life organizations. These reviews, which represent a unique feature of this text, describe the varied ways companies are dealing with the challenges of today's changing environment. New "BookMarks" in the Thirteenth Edition include *The Vanishing American Corporation: Navigating the Hazards of a New Economy*, *Meltdown: Why Our Systems Fail and What We Can Do About It*, *The Conversational Firm: Rethinking Bureaucracy in the Age of Social Media*, *Astroball: The New Way to Win It All*, *Blue Ocean Shift: Beyond Competing*, and *Rule Makers, Rule Breakers: How Tight and Loose Cultures Wire Our World*.

In Practice. This edition contains many new "In Practice" examples that illustrate theoretical concepts in organizational settings. Many examples are international, and all are based on real organizations. There are 38 new "In Practice" cases used within chapters, including Uber and Didi Chuxing, Grameen Veolia Water, Warner Media, LVMH Moët Hennessy Louis Vuitton, the Los Angeles Rams, Google and Alphabet, Netflix, Panera Bread Company, Inditex S.A.'s Zara, BAE Systems, Twitter, Volkswagen, Siemens Gamesa, Wells Fargo, Morgan Stanley, Huawei, and the National Rifle Association. "In Practice" examples that have been retained from the previous edition with substantial updating include Amazon Versus Walmart, Carnival Cruise Lines, Omnicom and Publicis, Taco Bell, Allegiant Air, and Apple and Samsung.

Manager's Briefcase. Located in the chapter margins, this feature tells students how to use concepts to analyze cases and manage organizations.

Text Exhibits. Frequent exhibits are used to help students visualize organizational relationships, and the artwork has been designed to clearly communicate chapter concepts.

Remember This. At the end of each major section of a chapter is a "Remember This" bullet-point summary of the key ideas and concepts discussed in that section. The "Remember This" feature gives students a convenient way to review the essential points covered in each major section of the chapter.

Case for Analysis. These cases are tailored to chapter concepts and provide a vehicle for student analysis and discussion. New cases for analysis include "Solo Eyewear," "Craft Originalities Inc.," "Hermitage Escalator Company," "Fiedler, Philips & Wilson Design," and "Digitalization in the Manufacturing Sector: Skills in Transition."

Integrative Cases. The integrative cases at the end of the text have been expanded and positioned to encourage student discussion and involvement. The new cases include *The New York Times* Versus Amazon, Lampang: Overcoming Community Resistance to a Sustainability Project, Walmart's Failures in Entering

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Three Developed Markets, and ToolTopia.com. Previous cases that have been substantially revised and updated include Cisco Systems: Evolution of Structure, Costco: Join the Club, and IKEA: Scandinavian Style.

New Concepts

The Thirteenth Edition contains an exceptional amount of new content. A new chapter looks at *dual-purpose organizations* that combine profit-seeking and social welfare goals, outlining designs for managing *mission drift* and the inherent goal conflict in these companies. This chapter also includes a significant consideration of designs for corporate sustainability and corporate social responsibility, including CSR, ESG, the triple bottom line, conscious capitalism, and the bottom of the pyramid concept. The chapter dealing with information technology has been completely revised to include new *platform-based digital organization designs*, the impact of *artificial intelligence* on organization design and management systems, and the trend toward *digitalization* of all organizations.

Other concepts that have been added or expanded in the Thirteenth Edition include the *Internet of Things* and its impact on big data analytics, a new form of control over employees called *algorithmic control*, the use of *nudge management* for influencing employees, the trend toward *bossless organization designs* and a new design called the *holacracy team structure*, new material on overly complex technologies and *high reliability organizations*, *cultural intelligence*, *reverse innovation*, the trend toward *glocalization*, decision fallacies and *cognitive biases*, designing a *high-performance culture*, *SWOT analysis*, *scenario planning*, and *hard versus soft power*.

Chapter Organization

Each chapter is highly focused and is organized into a logical framework. Many organization theory textbooks treat material in sequential fashion, such as "Here's View A, Here's View B, Here's View C," and so on. *Organization Theory and Design* shows how they apply in organizations. Moreover, each chapter sticks to the essential point. Students are not introduced to extraneous material or confusing methodological squabbles that occur among organizational researchers. The body of research in most areas points to a major trend, which is reported here. Several chapters develop a framework that organizes major ideas into an overall scheme.

This book has been extensively tested on students. Feedback from students and faculty members has been used in the revision. The combination of organization theory concepts, book reviews, examples of leading organizations, self-insight questionnaires, case illustrations, experiential exercises, and other teaching devices is designed to meet student learning needs, and students have responded favorably.

Supplements

Instructor Companion Website. Access important teaching resources on the companion website. For your convenience, you can download electronic versions of the instructor supplements at the password-protected section of the site, including the Instructor's Manual, Test Bank, and PowerPoint presentations.

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To access these additional course materials and companion resources, please visit www.cengagebrain.com. At the CengageBrain.com home page, search for the ISBN of your title (from the back cover of your book) using the search box at the top of the page. This will take you to the product page where free companion resources can be found.

Instructor's Manual. The Instructor's Manual contains chapter overviews, chapter outlines, lecture enhancements, discussion questions, discussion of activities, discussion of chapter cases, and case notes for integrative cases.

Cognero Test Bank. The Cognero Test Bank contains easy-to-use test creation software. Instructors can add or edit questions, instructions, and answers and can select questions (randomly or numerically) by previewing them on the screen. Instructors can also create and administer quizzes online.

PowerPoint Lecture Presentation. The PowerPoint Lecture Presentation enables instructors to customize their own multimedia classroom presentations. Prepared in conjunction with the text and instructor's resource guide, the package contains approximately 150 slides. It includes exhibits from the text as well as outside materials to supplement chapter concepts. Material is organized by chapter and can be modified or expanded for individual classroom use.

Acknowledgments

Textbook writing is a team enterprise. The Thirteenth Edition has integrated ideas and hard work from many people to whom I am grateful. Reviewers and focus group participants made an especially important contribution. They praised many features, were critical of things that didn't work well, and offered valuable suggestions.

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Eastern Kentucky University

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Robert Girling
Sonoma State University

Yezdi H. Godiwalla
University of Wisconsin-Whitewater

John A. Gould
University of Maryland

George Griffin
Spring Arbor University

Leda McIntyre Hall
Indiana University, South Bend

Ralph Hanke
Pennsylvania State University

Bruce J. Hanson
Pepperdine University

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Thomas Head
Roosevelt University

Patricia Holahan
Stevens Institute of Technology

Jon Kalinowski
Minnesota State University, Mankato

Guiseppe Labianca
Tulane University

Jane Lemaster
University of Texas–Pan American

Kim Lukaszewski
Wright State University

Steven Maranville
University of Saint Thomas

Rick Martinez
Baylor University

Ann Marie Nagye
Mountain State University

Janet Near
Indiana University

Julie Newcomer
Texas Woman's University

Frank Nolan
Liberty University

Asbjorn Osland
George Fox University

Laynie Pizzolatto
Nicholls State University

Paula Reardon
State University of New York, Delhi

Samantha Rice
Abilene Christian University

Richard Saaverda
University of Michigan

W. Robert Sampson
University of Wisconsin, Eau Claire

Amy Sevier
University of Southern Mississippi

W. Scott Sherman
Texas A&M University

Marjorie Smith
Pasadena City College

R. Stephen Smith
Virginia Commonwealth University

Filiz Tabak
Towson University

Thomas Terrell
Coppin State College

Jack Tucci
Southeastern Louisiana University

Renee Tyre
Wilmington University

Isaiah Ugboro
North Carolina A&T State University

Warren Watson
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Richard Weiss
University of Delaware

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Edition to continue its high level of excellence. I also thank DeeGee Lester for her work drafting new end-of-chapter and integrative cases. DeeGee's creative writing skills brought to life key organizational issues that students will enjoy discussing and solving.

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Richard L. Daft
Nashville, Tennessee
July 2019

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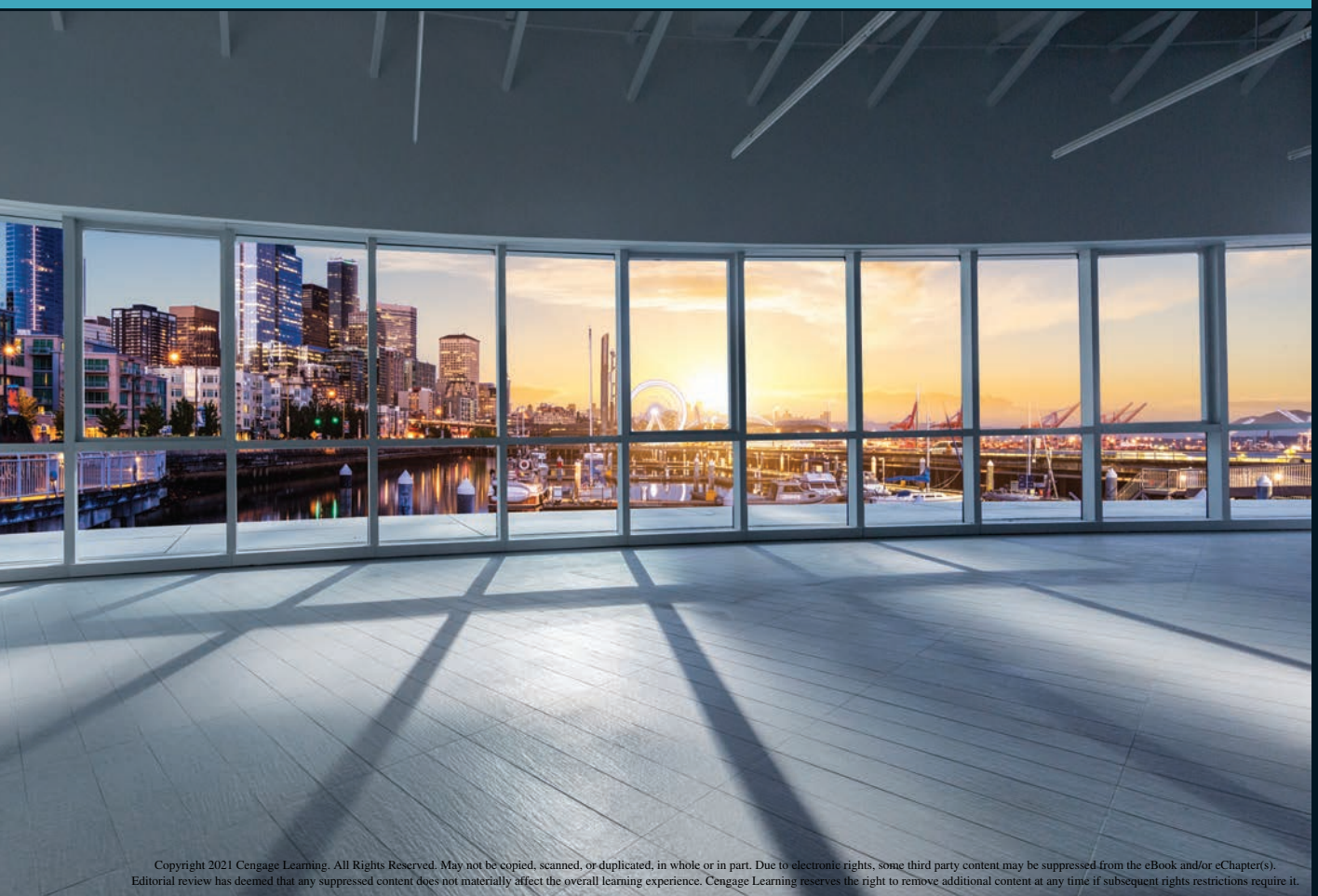
PART 1

Introduction to Organizations

Chapter 1 Organizations and Organization Design



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CHAPTER

1 Organizations and Organization Design

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Learning Objectives

After reading this chapter you should be able to:

1. Discuss current challenges that organizations face.
2. Describe the importance of organizations in society.
3. Describe how the structural dimensions of organizations are shaped by contingencies organizations face.
4. Outline the evolution of organizational design.
5. Compare and contrast organic and mechanistic organization designs, including the contingency factors typically associated with each.
6. Explain the current trend toward bossless organization design.

Chapter Outline

A Look Inside General Electric

The Jack Welch Era 1981–2001 · The Jeff Immelt Era 2001–2017 · Events Since 2017

Organization Design in Action

Topics · Purpose of This Chapter · Current Challenges

What Is an Organization?

Definition · From Multinationals to Nonprofits · Importance of Organizations

Dimensions of Organization Design

Structural Dimensions · Contingency Factors · Performance and Effectiveness Outcomes

The Evolution of Organization Design

Historical Perspectives · It All Depends: Key Contingencies

The Contrast of Organic and Mechanistic Designs

The Emerging Bossless Design Trend

Framework for the Book

Levels of Analysis · Plan of the Book · Plan of Each Chapter

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **An organization can be understood primarily by understanding the people who make it up.**

I AGREE _____ I DISAGREE _____

2 **The primary role of managers in business organizations is to achieve maximum efficiency.**

I AGREE _____ I DISAGREE _____

3 **A CEO's top priority is to make sure the organization is designed correctly.**

I AGREE _____ I DISAGREE _____

1.1 A Look Inside General Electric

General Electric (GE) has a glorious heritage. Founded by Thomas Edison in 1878 to generate and distribute electric power, GE became a world leader as a diversified industrial company. For decades, GE had a reputation for excellent and innovative management practices that other companies copied. As a model industrial company, General Electric's stock had been part of the Dow Jones Industrial Average since 1907.

Since the late 1800s, GE moved in and out of multiple businesses as a key part of its strategy and success. In 2019, GE was still a diversified worldwide conglomerate. Its industrial businesses included the power segment (gas and steam power systems), renewable energy (wind turbines), oil and gas (drilling systems), aviation (jet engines), healthcare (MRI machines), transportation (locomotives), and capital (loans to buy equipment).

However, by 2019 GE's value had fallen precipitously from its earlier prosperity, hitting a low of about 10 percent of its former value. How could a company that rose to fame as the best managed company in the world fall on such hard times? The answer to GE's ups and downs lies partly with how its leaders used organization design.

Reginald Jones was CEO from 1972 to 1981 and helped build GE's sophisticated strategic planning system. The GE conglomerate was composed of 43 autonomous businesses, within which it had 10 groups, 46 divisions, and 190 departments that participated in strategic planning. To help manage the massive amounts of paperwork and information required from 43 strategic plans, GE added a management layer to its structure to oversee sectors or groupings of businesses and reduce the load on top management. GE was a respected and highly successful company, and paperwork and bureaucracy seemed to increase along with organization size and complexity.

1.1a The Jack Welch Era 1981–2001

When he was hired as an engineer at GE in the early 1960s, Jack Welch hated the company's bureaucracy so much that he submitted his resignation after only six months on the job. Fortunately for GE, Welch's boss convinced him to stay and

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make a difference. After rising to CEO, Welch was quick to begin busting the ever-growing GE bureaucracy. Near the end of his two-decade run as CEO, in 2001, *Fortune* magazine named Welch "Manager of the Century" to recognize his astonishing record at GE and also named GE the "Most Admired Company in the United States." What changes did Welch and GE managers make to achieve these accolades?

Strategy Changes. GE had begun using the advertising slogan "We bring good things to life" in the late 1970s and it continued in the Welch era, with Welch maintaining the strategy of being a conglomerate of diverse businesses. But Welch added a new key objective: each business must become the No. 1 or No. 2 competitor in its industry or risk being cut. GE's new strategy was to be a leader in each of its industries.

Changes in Structure. Welch attacked the bureaucratic layers within GE by first eliminating the sector level of management hierarchy that Reginald Jones created. He continued to fight the over-managed hierarchy until the number of levels was reduced from nine to as few as four. In many cases, department managers, subsector managers, unit managers, and sometimes supervisors were eliminated along with the sector managers. Now the CEO and top managers could deal directly with each business without going through multiple layers of hierarchy. Moreover, Welch stretched senior managers' span of control to 15 or more direct reports to force more delegation and autonomy downward.

Downsizing. Welch's assault on the bureaucracy also involved cutting down the number of employees. GE eliminated tens of thousands of managers and employees through delayering and de-staffing and even more through divestitures. The number of GE employees declined from about 404,000 in 1982 to 292,000 by 1989. Welch was given the nickname "Neutron Jack" because a neutron bomb killed people and left buildings intact. The nickname was reinforced by the CEO's replacement of 12 of his 14 business heads. During this period, Welch was named "toughest boss in America."

A New Culture. Welch wanted a corporate culture based on direct conversations of openness and candor, eyeball to eyeball, between managers and direct reports rather than via formal meetings and bureaucratic paperwork. A practice called Work-Out was one answer. Groups of up to 100 employees from a business unit would gather in a town meeting-style atmosphere. The business unit boss presented a challenge and left the room. Employees divided into teams and attacked problems and bureaucratic inefficiencies in their business unit with new, often dramatic, solutions. On the third day, bosses returned and listened to the teams' presentations. Bosses had about one minute to decide whether to accept or reject each proposal. One boss from an aircraft engine factory accepted 100 of 108 proposals, enabling a transformation in factory operations. Bosses often lost their jobs if they were unable to accept the dramatic change proposals from subordinates. Over 10 years, about 200,000 GE members participated in Work-Out.

Going Global. Welch also focused GE on global expansion. The U.S. market was not big enough. Welch encouraged international expansion by increasing the standard for business unit performance from being the "No. 1 or No. 2" business in your industry to being the No. 1 or No. 2 business in *the world*! To support each company's global effort, he hired a senior manager of International Operations to facilitate each business's overseas expansion. GE managers had to learn to think and act globally.

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Performance Management, Stretch Goals, and Control. Welch and his most senior executives were responsible for the progress of GE's top 3,000 executives. They visited each company to review progress toward stated targets, often including "stretch" goals, another concept Welch introduced. Stretch goals used managers' "dreams" as targets that might be impossible to reach but would motivate exceptional accomplishment. In another move, Welch installed a manager evaluation system on a "vitality curve." This annual review process became known as "rank and yank," because the top 20 percent received generous rewards, the vital 70 percent were largely left alone, and the bottom 10 percent were encouraged to leave the company.

E-Business. About two years from retirement, Welch saw the potential of the Internet as "the biggest change I have ever seen." He thought a big, traditional company like GE might be afraid of the new technology, so he required each business unit to establish a full-time team charged with including strategic opportunities for the Internet. Digitizing the company was Welch's final major initiative.

To summarize, the Jack Welch era at GE was the most phenomenal in company history. Welch and GE earned prestigious awards, such as *Financial Times* naming GE the "Most Admired Company in the World." Moreover, Jack Welch became an icon for brilliant management and his name became known in popular culture. GE's market value increased an astonishing 27 times from $18 billion to $500 billion under Welch's guidance. In the year 2000, GE was the most valuable company in the world.

1.1b The Jeff Immelt Era 2001–2017

Welch personally chose Jeff Immelt to become GE's new CEO. Immelt had broad experience at GE, changing jobs often across GE Appliance, GE Plastics, and GE Healthcare, eventually running the healthcare unit.

The External Environment. Immelt and GE faced major environmental challenges almost from Day 1—starting with the September 11, 2001 terrorist attacks that stunned the world. GE also endured the 2002 stock market crash, an oil price collapse, and the 2008 collapse of Wall Street and the long global recession that followed.

Strategy Changes. Immelt shifted GE toward an industrial business focus consistent with GE's industrial roots while simultaneously learning to thrive in the Internet age. He added software capability to GE and predicted GE would become a major software company. Immelt also placed special emphasis on globalization and on more innovations via greater investments in research and development.

Innovation. Under Immelt's watch, GE developed a new concept called "reverse innovation." GE's innovation strategy for decades had been to develop high-end products in the United States and then sell the products internationally with modest adaptations to fit local conditions. Reverse innovation means to develop low-end products in poor countries and then sell those products in wealthy, well-developed countries. One example was the development of a cheap, portable ultrasound machine in China that was also sold successfully in the United States and Europe.

Sustainability. At GE, sustainability means aligning business strategy to meet societal needs, while minimizing environmental impact and advancing social development. Immelt pushed GE to embed sustainability at every level, from high-visibility

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initiatives such as Ecomagination (building machines that produce cleaner energy, reduce greenhouse gas emissions, and reduce clean water use) down to day-to-day safety management for employees. Sustainability also means promoting diversity, investing for affordable healthcare, investing in clean energy, and meeting ambitious environmental goals to reduce emissions.

Big Decisions. Immelt's biggest decisions were to sell most of GE Capital and to acquire the French energy business Alstom. GE Capital provided a variety of financial services—credit cards, car loans, real estate loans, subprime mortgages, and equipment leasing. GE Capital was a highly profitable business. After the 2008 financial crisis, however, GE Capital was designated "too big to fail." Investors feared huge losses, so large parts of GE Capital were divested. This was a tough decision because in some previous good years GE Capital provided nearly half of GE's revenue and profits.

The Alstom acquisition decision proved to be something of a disaster. At $13 billion, it was GE's largest industrial acquisition. Managers soon realized not only that Alstom was operating inefficiently, but the demand for its gas-powered generation equipment was in decline. Immelt ordered Alstom to downsize by 12,000 employees. After paying $13 billion for Alstom, GE later took a write down of almost $20 billion.

More Globalization. Immelt pushed international business beyond Welch's earlier goals. He increased global revenue to 55 percent of total revenue compared to 30 percent when he took over. He explained that 90 percent of aircraft engines, 100 percent of gas turbines, and 50 percent of locomotives that GE manufactures leave the country. "That is where the customers are," he said. Immelt championed the launch of GE's Global Growth Organization (GGO), designed to work across the business units to increase sales in markets outside the United States.

Digitalizing for Big Data Analytics. Immelt sponsored a large research effort into a sophisticated data analytics platform called Predix. This cloud-based operating system would allow GE to put sensors on industrial equipment sold to customers (e.g., jet engines, locomotives) that would provide huge volumes of data to analyze machine performance and predict maintenance requirements. These data would enable GE to offer new and profitable services to customers.

To summarize Immelt's era at General Electric, most analysts thought GE fell behind rather than moved ahead. Immelt did all he could over his time as CEO to increase the value of GE stock, but over those 17 years share price declined by close to 30 percent while comparable companies (the S&P 500) rose by 124 percent. GE shed more than $150 billion in value compared to the $480 billion increase during Jack Welch's reign. Some analysts argued that the GE conglomerate should be broken up or dramatically slimmed down by selling its pieces and killing all investments in R&D and innovation. They criticized Immelt for being overly optimistic in his decisions and for not confronting the reality of GE's problems.

1.1c Events Since 2017

In 2017, GE announced that John Flannery, head of GE Healthcare, would follow Immelt as CEO. GE's stock price soon dropped 45 percent. GE hit rock bottom during late 2018 and early 2019—its market value was about 1/10 of its peak under Jack Welch. The stock dividend that had supported GE widows and seniors for

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decades was cut to a single penny. The icing on the not-so-pretty cake was when GE was cut from its coveted position in the prestigious Dow Jones Industrial Average.

GE's Board of Directors soon decided that Flannery lacked the experience to handle the flow of crises at GE while he was still learning the company. The new CEO was 55-year-old Larry Culp, Lead Director on GE's Board, who had 14 years' experience as CEO of Danaher Corporation. People are counting on Culp to reinstate the kind of business culture at GE that inspired other companies to copy it. Culp thought GE had become too large and complicated to be managed effectively, and he decided to slim down the company, including selling GE's biotechnology business for $21 billion. During Culp's first few months as CEO in 2019, GE's stock started moving in a positive direction. With hope and hard work, managers, employees, and analysts expect the renewal of GE into an image of its former self will continue.[1]

1.2 Organization Design in Action

Welcome to the real world of organization design. The shifting fortunes of GE illustrate organization design in action. GE managers were deeply involved in organization design each day of their working lives—but many never realized it. Company managers didn't fully understand how the organization related to the environment or how it should function internally. Organization design gives us the tools to evaluate and understand how and why some organizations grow and succeed while others do not. It helps us explain what happened in the past, as well as what might happen in the future, so that we can manage organizations more effectively. Organization design concepts can help Larry Culp and other GE managers analyze and diagnose what is happening and the changes that will help GE keep pace with a fast-changing world. Organization design gives people the tools to explain the decline of GE and recognize the steps managers might take to keep the company competitive.

Similar problems have challenged numerous organizations. Toyota Motor Corporation, for example, had the best manufacturing system in the world and was the unchallenged auto quality leader for decades. But when top managers started implementing high-pressure goals for extensive global growth, the famous quality system was strained to a breaking point. By 2009, Toyota found itself in the middle of a crisis that culminated in the recall of more than 9 million cars due to quality problems.[2] Sales at Papa John's pizza chain dropped after a highly-publicized incident of founder John Schnatter using a racial slur led to the exposure of a corporate culture that belittled women and minorities. Schnatter resigned. The Board of Directors asked an outside firm to oversee an audit of the corporate culture, and the company began holding workshops on diversity and inclusion to try to fix the dysfunctional culture.[3] Or consider Kodak, the company that once ruled the photographic film business. Kodak invented one of the first digital cameras and spent hundreds of millions of dollars developing digital technology, but the fear of cannibalizing their lucrative film business paralyzed managers when the time came to go to market. Kodak filed for bankruptcy in 2012 and is now a shell of the company it was prior to the digital camera revolution.[4]

1.2a Topics

Each of the topics to be covered in this book is illustrated in the opening General Electric case. Indeed, managers at organizations such as General Electric, Toyota,

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Kodak, and Papa John's are continually faced with a number of challenges. For example:

- How can the organization adapt to or control such external elements as competitors, customers, government, and creditors in a fast-paced environment?
- What strategic and structural changes are needed to help the organization attain effectiveness?
- How can the organization avoid management ethical lapses that could threaten its viability?
- What changes are needed to address the growing demand for organizations to pay attention to sustainability issues?
- How can managers cope with the problems of large size and bureaucracy?
- What is the appropriate use of power and politics among managers?
- How should internal conflict and coordination between work units be managed?
- What kind of corporate culture is needed and how can managers shape that culture?
- How much and what type of innovation and change is needed?

These are the topics with which organization theory and design is concerned. Organization design concepts apply to all types of organizations in all industries. Managers at Hyundai, for example, turned the Korean auto manufacturer once known for producing inexpensive no-frills cars with a poor reputation into the world's third largest automaker by relentlessly focusing on quality, cost-control, and customer satisfaction. After Google pulled its search engine and Gmail out of China in protest over censorship and government hacking, managers found a way to keep a foothold in the lucrative market by building relationships with local partners such as Mobvoi, Tencent Holdings Ltd., and others. Google has been negotiating to provide software and cloud-hosting services that would run on a data center owned by a Chinese local partner. Managers at the Swedish furniture giant IKEA are undertaking the most dramatic restructuring in company history to cope with rapid changes in shopping habits.[5] All of these companies are using concepts based in organization design. Organization design also applies to nonprofit organizations such as United Way, Best Friends Animal Society, local arts organizations, colleges and universities, and the Make-A-Wish Foundation, which grants wishes to terminally ill children.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Do not ignore the external environment or protect the organization from it. Because the environment is unpredictable, do not expect to achieve complete order and rationality within the organization. Strive for a balance between order and flexibility.

Organization design draws lessons from organizations such as GE, Google, and United Way and makes those lessons available to students and managers. As our opening example of GE shows, even large, successful organizations are vulnerable, lessons are not learned automatically, and organizations are only as strong as their decision makers. Research shows that many new companies don't survive past their fifth birthday, yet some organizations thrive for 50 or even 100 years. Organizations are not static; they continuously adapt to shifts in the external environment. Today, many companies are facing the need to transform themselves into dramatically different organizations because of new challenges in the environment.

1.2b Purpose of This Chapter

The purpose of this chapter is to explore the nature of organizations and organization design today. Organization design has developed from the systematic study of organizations by scholars. Concepts are obtained from living, ongoing organizations. Organization theory and design has a practical application, as illustrated

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by the GE case. It helps managers understand, diagnose, and respond to emerging organizational needs and problems.

We first take a deeper look at the challenges today's managers and organizations face. The next section begins with a formal definition of the organization as an open system and then explores introductory concepts for describing and analyzing organizations, including various structural dimensions and contingency factors. We introduce the concepts of efficiency and effectiveness and describe the most common approach to measuring organizational performance. Succeeding sections examine the history of organization design, the distinction between mechanistic and organic designs, and how organization theory can help people manage complex organizations in a rapidly changing world. The chapter closes with a brief overview of the themes to be covered in this book.

1.2c Current Challenges

Research into hundreds of organizations provides the knowledge base to make GE and other organizations more effective. Challenges organizations face today are different from those of the past, and thus the concept of organizations and organization design is evolving. This chapter's BookMark describes two recent organizational forms that are altering the organizational landscape. The world is changing more rapidly than ever before, and managers are responsible for positioning their organizations to adapt to new needs. Some specific challenges today's managers and organizations face are globalization, intense competition, rigorous scrutiny of sustainability and ethical practices, the need for rapid response, and incorporating digital business and big data analytics.

Globalization. The cliché that the world is getting smaller is dramatically true today. Markets, technologies, and organizations are becoming increasingly interconnected.[6] Managers who can help their companies develop a global perspective are in high demand. For example, consider Ramon Laguarta, a native of Barcelona, Spain, who took over as CEO of PepsiCo in 2018, Indian American Sundar Pichai, CEO of Google, or Medtronic CEO Omar Ishrak, a Bangladesh native who was educated in the United Kingdom and worked in the United States for nearly two decades.

Today's successful organizations feel "at home" anywhere in the world. Companies can locate different parts of the organization wherever it makes the most business sense: top leadership in one country and technical brainpower and production in other locales. Related trends are *global outsourcing,* or contracting out some functions to organizations in other countries (Nike), and *strategic partnering* with foreign firms to gain a global advantage (Google). Cross-border acquisitions and the development of effective business relationships in other countries are vital to many organizations' success. Yet doing business on a global scale is not easy. After a new European Union privacy law went into effect in mid-2018, the French data protection authority fined Google 50 million euros (about $57 million) for not properly disclosing to users how it collected data to provide personalized ads.[7] Uber has pulled out of several global markets, including China, Russia, and Southeast Asia, after it got into trouble defying government regulations in various countries.[8] Another issue concerns outsourcing and contractor relationships. Several garment factory fires in Bangladesh and the collapse of another apparel plant that killed more than 1,100 workers put the spotlight on poor working conditions in that country.

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BOOKMARK 1.0 HAVE YOU READ THIS BOOK?

The Vanishing American Corporation: Navigating the Hazards of a New Economy

By Gerald F. Davis

Is the large American corporation dead? No, but in his book *The Vanishing American Corporation,* Gerald F. Davis reminds us just how much the organizational landscape has changed since companies like General Motors, Xerox, and AT&T seemed to rule the world. Davis presents the astounding fact that the number of publicly held corporations in the United States declined by half in less than 20 years, from a high of 7,322 in 1996 to 3,659 in 2015. Why are huge companies shrinking, declining, and sometimes disappearing altogether?

NEW FORMS FOR A NEW CENTURY

One important factor is that new organization forms have emerged that seem a better fit for today's business environment. The large corporation, Davis says "fit well with the requirements of doing business in the 20th century, but it is increasingly bad for 21st century business." He describes two recent design approaches enabled by the twin forces of technology and globalization, labelling them by the companies that clearly exemplify them.

- *Nikefication: The Virtual Network Organization*. In a virtual network form, the company keeps high value-added tasks in-house (in Nike's case, sneaker design and marketing) and outsources other components (such as manufacturing of sneakers) to outside contractor companies, often in low-wage countries. A network form allows a smaller and less complex company to provide goods and services more rapidly and at lower cost. In one year, for instance, Vizio (with 200 employees) sold as many televisions in the United States as Sony (with 150,000 employees). Some companies operate entirely as network organizations, but with the Internet and a growing availability of contractors, "Nikefication is now standard practice across corporate America" Davis points out.
- *Uberization: The Platform-Based Organization.* A newer type of organization, best demonstrated by the ride-hailing service Uber, uses a specific combination of information and communication technologies to connect different groups of people and allow them to engage in mutually-beneficial exchanges. "Such organizations provide the digital platform for a market that matches those who have tasks to do with self-starters willing to do them," Davis writes. Uber, for example, provides the platform that matches customers who need a ride to Uber driver-partners, who are "not employees (absolutely not!) but independent micro-entrepreneurs." This organization form reduces labor costs, enables a company to be extremely agile, and maximizes the speed of customer service.

WHAT DOES IT ALL MEAN?

Davis presents both positive and negative consequences for individuals and societies. With the decline of large corporations and the emergence of new forms, a lifelong career with a single company is a thing of the past. Hierarchies are flattened, so people no longer have a clear path for advancing their careers. They are not employees and have no physical workplace where they meet with others. However, these new forms also offer opportunities. Entrepreneurs and managers can shape businesses that are more local and community based, that give people greater opportunities for participation, and that pay more attention to sustainable business practices. The virtual network and digital platform organization designs will be discussed in Chapters 3 and 9.

The Vanishing American Corporation, by Gerald F. Davis, is published by Berrett-Koehler Publishers.

The problem for organizations such as Walmart, H&M, Target, Apple, Amazon and other big companies that outsource is that similar poor working conditions exist in other low-wage countries such as Pakistan, Cambodia, Indonesia, and Vietnam that produce much of the world's clothing and other products.[9]

Intense Competition. The growing global interdependence creates new advantages, but it also means that the environment for companies has become extremely complex and extremely competitive. Customers want low prices for quality goods and services, and the organizations that can meet that demand will win. Outsourcing firms in low-wage countries can often do work for 50 to 60 percent less than companies based in the United States, for instance, so U.S. firms that provide similar

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services have to search for new ways to compete or go into new lines of business.[10] One entrepreneur who developed a new type of battery for notebook computers decided to have it manufactured by a factory in Shenzhen, China. She wanted to produce the product in the United States, but U.S. contract manufacturers wanted millions of dollars up front, a demand not made by any of the manufacturers she met with in China.[11]

Companies in all industries are feeling pressure to drive down costs, keep prices low, and meet shifting demands. Retailers provide a stark example. Tesco, the largest supermarket chain in the United Kingdom, implemented a price-cutting campaign and is slashing thousands of jobs to trim costs as it faces growing competition from discount chains Aldi and Lidl and online shopping sites. Executives at firms including Macy's, J. C. Penney, Family Dollar, and Gap announced the closing of additional stores in early 2019, reflecting a failure to adapt as competition and shopping habits change. Other traditional retailers, including Walmart, Target, and Best Buy, on the other hand, have seen sales increase as their managers have found ways to compete with Amazon online while also finding the right mix of products and services to bring people into their physical stores.[12]

Sustainability, the Green Movement, and Ethics. Today's managers face tremendous pressure to "dial down their single-minded pursuit of financial gain and pay closer attention to [the organization's] impact on employees, customers, communities, and the environment."[13] People are demanding a stronger commitment by organizations to balance profit and public interest. Many companies are embracing the philosophy of sustainability, which refers to economic development that generates wealth and meets the needs of the current generation while saving the environment so future generations can meet their needs as well.[14] Sustainable development has emerged as a key goal for organizational growth and development.[15] As mentioned in the chapter opening case, Jeff Immelt pushed GE to embed sustainability at every level of the company.

Going green has become a new business imperative, driven by shifting social attitudes, new government policies, climate change, and the information technology that quickly spreads news of a corporation's negative impact on the environment. At Interface, an Atlanta-based carpet manufacturer, founder and former chairman Ray C. Anderson implemented "Mission Zero," a pledge to reduce the use and production of virgin raw materials and eliminate the company's impact on the environment. Current CEO Jay Gould is following in Anderson's footsteps, with Interface becoming in 2018 one of the first flooring manufacturers to announce a goal of carbon neutrality. "We really talk about four key stakeholders" Gould says about the company's commitment to sustainable business practices. "Our customers, our employees, our shareholders—and the environment."[16]

Managers are also feeling pressure from the government and the public to hold their organizations and employees to high ethical and professional standards. Following widespread moral lapses and corporate financial scandals, organizations are under scrutiny as never before. Facebook and other tech companies, for instance, have frequently been targeted in recent years by regulators and others demanding more oversight. In early 2019, a British parliamentary committee issued a blistering report concluding that internal Facebook e-mails prove that the company is willing to sacrifice user privacy for the sake of generating more advertising and increasing its revenue. "Social media companies cannot hide behind the claim of being merely a 'platform' and maintain that they have no responsibility themselves in regulating the content of their sites," the report said, calling for new laws regulating the industry. [17] Non-tech companies aren't immune

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to the scrutiny. Consulting firm McKinsey & Company recently agreed to a $15 million settlement with the U.S. Justice Department to resolve an investigation into charges that the company failed to properly disclose its financial connections to other parties while working on bankruptcy cases.[18]

Speed and Responsiveness. A fourth significant challenge for organizations is to respond quickly and decisively to environmental changes, organizational crises, or shifting customer expectations. For much of the twentieth century, organizations operated in a relatively stable environment, so managers could focus on designing structures and systems that kept the organization running smoothly and efficiently. There was little need to search for new ways to cope with increased competition, volatile environmental shifts, or changing customer demands. Today, new products, new companies, and even entirely new industries rise and fall faster than ever.

As previously mentioned, the retail industry is undergoing a rapid and dramatic transformation. In what has been called the "retail apocalypse," dozens of retailers, including Payless, Aeropostale, Mattress Firm, Sears, Radio Shack, Bon Ton, and Toys "R" Us, have filed for bankruptcy in recent years. Some have gone out of business entirely, while others are closing stores and struggling to survive.[19] Online retail giant Amazon continues to change the game. Amazon is continuously experimenting with new ideas, pulling the plug quickly on those that don't work out. In early 2019, managers announced that Amazon would shut down all 87 of its U.S. pop-up stores, small kiosk stores that operated in locations such as malls, Kohl's stores, and Whole Foods Market locations. Meanwhile, the company continues to explore a brick-and-mortar strategy, opening more bookstores and 4-Star Stores (which sell products rated 4 stars or higher by Amazon.com customers) and planning for a new line of grocery stores. Founder and CEO Jeff Bezos believes most business decisions have to be made quickly "with somewhere around 70 percent of the information you wish you had."[20]

Managers in other industries must also think fast and act fast. The large consumer products firm Procter & Gamble is cutting its divisions from 10 to 6 and giving managers of those divisions more control and decision-making authority. "There is a need for greater agility," said CEO David Taylor. "Frankly, the volatility we see in many parts of the world . . . has increased meaningfully the speed of change."[21] Considering the turmoil and flux inherent in the world, managers and companies need a mindset of continuous reinvention to succeed, which typically means giving people on the frontlines the power to experiment and make decisions.[22]

Digital Organizations and Big Data Analytics. Today's realm of the Internet, social networking, blogs, online collaboration, web-based communities, podcasting, mobile devices, Twittering, Facebooking, YouTube-ing, and Skype-ing is radically different from the world many established managers are familiar and comfortable with.[23] The digital revolution has changed everything—not just how we communicate with one another, find information, and share ideas, but also how organizations are designed and managed, how businesses operate, and how employees do their jobs.

One significant aspect of the digital revolution is the use of **big data analytics**, which refers to technologies, skills, and processes for searching and examining massive sets of data to uncover hidden patterns and correlations.[24] GE attached data sensors to internal moving parts on its massive machines to analyze billions of data bits to assess wear and predict maintenance needs. Facebook uses the personal data you put on your page and tracks and monitors your online behavior along with everyone else's, then searches through all those data to identify and suggest potential friends. That kind of data

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collected by Facebook and Google also explains why ads pop up on your computer screen when you use an Internet browser. Netflix drills through tons of data it collects on its subscribers interests to determine which new shows and movies to offer and how to promote them.[25] However, big data is not just for online companies. Walmart collects more than 2.5 petabytes of data every hour from customer transactions and uses those data to make better decisions (a petabyte is about a million gigabytes or the equivalent of about 20 million filing cabinets full of written data).[26]

The example of how Foot Locker uses data analytics illustrates the benefits and the challenges it can bring.

IN PRACTICE
Foot Locker

FREEDOMPIC/Shutterstock.com

In the fall of 2018, Foot Locker surprised customers and potential customers with an augmented-reality (AR) scavenger hunt, timed to coincide with the release of LeBron 16 King Court Purple sneakers in Los Angeles. People used their smartphones or mobile devices to unlock geo-targeted AR clues throughout the city that would eventualy lead them to where they could find the limited-edition footwear.

Foot Locker managers know that young, tech-savvy "sneakerheads" want tomorrow's shoes today. Meeting that desire means using new technology all across the organization. The company's technology staff has grown by 30 percent over the past three years, with teams working on data apps, interfaces between apps and operating systems, artificial intelligence, augmented reality, and machine learning. To keep in touch with a rapidly shifting environment, Foot Locker does four or five technology releases such as new mobile apps or customer-facing dot-coms a week, and CIO Pawan Verna says at times there are "four or five a day." The company also applies digital technology to rapidly turn digital dreams into real-world products and services.

Verna says the key challenge for Foot Locker in working with AI and emerging digital technology is security. "For example, when we have a product launch . . . billions of bots mimicking customers will try to render our websites and mobile apps useless by staging distributed denial-of-service attacks on our internal and cloud infrastructure." Another challenge is making sure the company is transparent with customers, vendors, and others about the data it collects and how it uses that information.[27]

REMEMBER THIS

- Organization design provides tools to understand, design, and manage organizations more successfully, including issues such as how to adapt to a changing environment, cope with increasing size and complexity, manage internal conflict and coordination, and shape the right kind of culture to meet goals.
- Managers face new challenges, including globalization, intense competition, rigorous scrutiny of sustainability, environmental, and ethical practices, the need for rapid response, and incorporating big data analytics and digital business.
- New organization forms, referred to as Nikefication (virtual network design) and Uberization (digital platform design) are influencing organizations in all industries.

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1.3 What Is an Organization?

Organizations are hard to see. We see outcroppings, such as a tall building, a computer workstation, or a friendly employee, but the whole organization is vague and abstract and may be scattered among several locations, even around the world. We know organizations are there because they touch us every day. Indeed, they are so common that we take them for granted. We hardly notice that we are born in a hospital, have our birth records registered in a government agency, are educated in schools and universities, are raised on food produced on corporate farms, use our phones to hail a ride, purchase clothes, or have groceries delivered, buy a house built by a construction company and sold by a real estate agency, borrow money from a bank, turn to police and fire departments when trouble erupts, use moving companies to change residences, and receive an array of benefits from various government agencies.[28] Most of us spend many of our waking hours working in an organization of one type or another.

1.3a Definition

Organizations as diverse as a bank, a consumer products company, a ride-hailing service, a corporate farm, a social networking site, and a government agency have characteristics in common. The definition used in this book to describe organizations is as follows: **organizations** are (1) social entities that (2) are goal-directed, (3) are designed as deliberately structured and coordinated activity systems, and (4) are linked to the external environment.

An organization is a means to an end and it has to be designed to accomplish that end. It might be thought of as a tool or machine to get things done and achieve a specific purpose. The purpose will vary, but the central aspect of an organization is the coordination of people and resources to collectively accomplish desired goals.[29] An organization is not a building or a set of policies and procedures; organizations are made up of people and their relationships with one another. An organization exists when people interact with one another to perform essential functions that help attain goals. Managers and owners deliberately structure organizational resources to achieve the organization's purpose. However, even though work may be structured into separate departments or sets of activities, most organizations today are striving for greater horizontal coordination of work activities, often using teams of employees from different functional areas to work together on projects. Boundaries between departments, as well as those between organizations, are becoming more flexible and diffuse as companies face the need to respond to changes in the external environment more rapidly. An organization cannot exist without interacting with customers, suppliers, competitors, and other elements of the external environment. Some companies are even cooperating with their competitors, sharing information and technology to their mutual advantage. Exhibit 1.1 shows the organization as an **open system** that obtains inputs from the external environment, adds value through a transformation process, and discharges products and services back to the environment.

1.3b From Multinationals to Nonprofits

Some organizations are large, multinational corporations, such as General Electric, Google, and American Express; others are small, family-owned businesses; and still others are nonprofit organizations or governmental agencies. Some manufacture

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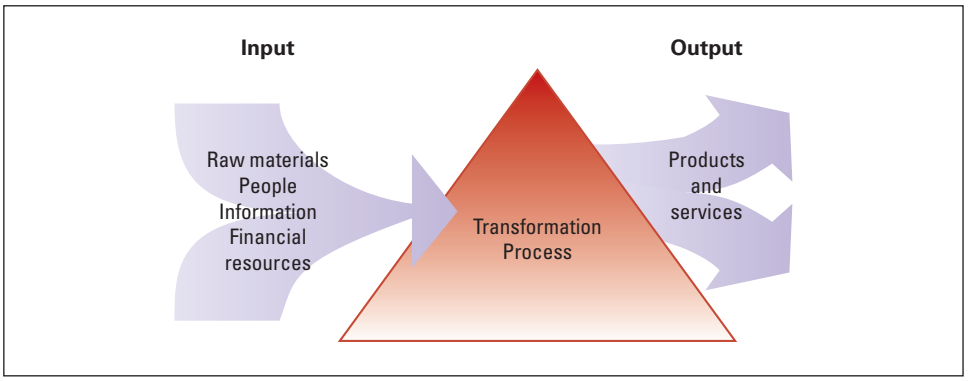

EXHIBIT 1.1
The Organization Is an Open System

products such as jet engines, flat-panel televisions, or smartphones, whereas others provide services such as legal representation, Internet and telecommunications services, mental health resources, or car repair. Later in this text, Chapter 8 will look at the distinctions between manufacturing and service technologies. Chapter 10 discusses size and life cycle and describes some differences between small and large organizations.

Another important distinction is between for-profit businesses and *nonprofit organizations*. All of the topics in this text apply to nonprofit organizations such as United Way, the Nature Conservancy, Habitat for Humanity, and St. Jude Children's Research Hospital, just as they do to businesses such as General Electric, Uber, Netflix, and Taco Bell. However, there are some important distinctions to keep in mind. The primary difference is that managers in businesses direct their activities toward earning money for the company and its owners, whereas managers in nonprofits direct much of their effort toward generating some kind of social impact. The unique characteristics and needs of nonprofit organizations present unique challenges for organizational leaders.[30]

Financial resources for government and charity nonprofits typically come from government appropriations, grants, and donations, rather than from the sale of products or services to customers. In businesses, managers focus on improving the organization's products and services to increase sales revenues. In nonprofits, however, services are typically provided to nonpaying clients, and a major problem for many organizations is securing a steady stream of funds to continue operating. Nonprofit managers, committed to serving clients with limited funds, must focus on keeping organizational costs as low as possible and demonstrating a highly efficient use of resources. Moreover, for-profit firms often compete with nonprofits for limited donations through their own philanthropic fundraising efforts.[31]

New forms of social welfare organizations, called hybrid or dual-purpose organizations, are designed to earn a profit and be self-sufficient rather than raise funds. Balancing the profit-seeking and social welfare sides of the organization is discussed in Chapter 7. Moreover, many nonprofit organizations, such as hospitals and private universities, do have a "bottom line" in the sense of having to generate enough revenues to cover expenses, buy new equipment, upgrade technology, and so forth, so managers often struggle with the question of what constitutes organizational effectiveness. It is easy to measure dollars and cents, but the metrics of success in dual-purpose and nonprofits are much more ambiguous. Managers have to measure intangible goals such as "improve public health," "make a difference in the lives of the disenfranchised," or "enhance appreciation of the arts."

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BRIEFCASE

As an organization manager, keep this guideline in mind:

Consider the needs and interests of all stakeholders when setting goals and designing the organization to achieve effectiveness.

Managers in nonprofit organizations also deal with many diverse stakeholders and must market their services to attract not only clients (customers) but also volunteers and donors. This can sometimes create conflict and power struggles among organizations, as illustrated by the Make-A-Wish Foundation, which has found itself at odds with smaller, local wish-granting groups as it expands to cities across the United States. The more kids a group can count as helping, the easier it is to raise funds. Local groups don't want Make-A-Wish invading their turf, particularly at a time when charitable donations in general have declined. "We should not have to compete for children and money," says the director of the Indiana Children's Wish Fund. "They [Make-A-Wish] use all their muscle and money to get what they want."[32]

Thus, the organization design concepts discussed throughout this book, such as dealing with issues of power and conflict, setting goals and measuring effectiveness, coping with environmental uncertainty, implementing effective control mechanisms, and satisfying multiple stakeholders, apply to nonprofit organizations such as the Indiana Children's Wish Fund just as they do to businesses such as General Electric. These concepts and theories are adapted and revised as needed to fit the unique needs and problems of various small, large, profit, or nonprofit organizations.

1.3c Importance of Organizations

It may seem hard to believe today, but organizations are relatively recent in the history of humankind. Even in the late nineteenth century there were few organizations of any size or importance—no labor unions, no trade associations, and few large businesses, nonprofit organizations, or governmental agencies. What a change has occurred since then! The development of large organizations transformed all of society, and, indeed, the modern corporation may be the most significant innovation of the past 150 years.[33]

Organizations are all around us and shape our lives in many ways. But what contributions do organizations make? Why are they important? Exhibit 1.2 indicates seven reasons organizations are important to you and to society. First, recall that an organization is a means to an end. Organizations bring together resources to accomplish specific goals. A good example is Northrup Grumman, which builds nuclear-powered, Nimitz-class aircraft carriers. Putting together an aircraft carrier is an incredibly complex job involving 47,000 tons of precision-welded steel, more than 1 million distinct parts, 900 miles of wire and cable, and more than seven years of hard work by 17,800 employees.[34] How could such a job be accomplished without an organization to acquire and coordinate these varied resources?

Organizations also produce goods and services that customers want at competitive prices. Companies look for innovative ways to produce and distribute desirable goods and services more efficiently. Many manufacturing companies, for example, have redesigned their production processes, applying artificial intelligence, 3-D printing, advanced robotics, and other emerging technologies, to provide products more efficiently and at lower cost.[35] Redesigning organizational structures and management practices can also contribute to increased efficiency. Organizations create a drive for innovation rather than a reliance on standard products and outmoded approaches to management and organization design.

Organizations adapt to and influence a rapidly changing environment. Motorcycle maker Harley-Davidson, in business for well over a century, has been struggling for several years to adapt to a shifting environment. Motorcycle sales overall are declining, and Harley's customer base is made up largely of aging baby-boomers.

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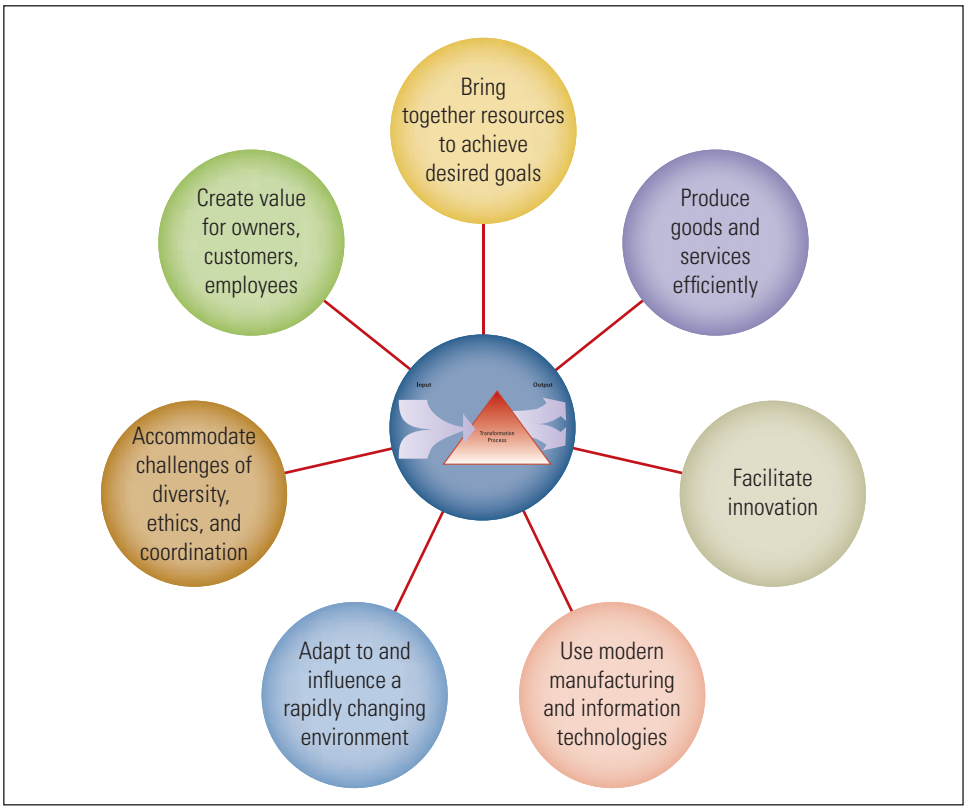
Bring together resources to achieve desired goals
Produce goods and services efficiently
Facilitate innovation
Use modern manufacturing and information technologies
Adapt to and influence a rapidly changing environment
Accommodate challenges of diversity, ethics, and coordination
Create value for owners, customers, employees
Input
Output
Transformation Process

EXHIBIT 1.2
Importance of Organizations

Although Harley has improved efficiency at many of its plants and come out with new models to attract younger riders, the company is still under pressure. In early 2019, Harley announced that its profit for the fourth quarter of 2018 was effectively zero.[36] One company that illustrates how organizations adapt to a changing environment is the fast fashion company Zara.

IN PRACTICE
Zara SA

Zara opened its first clothing retail store in Spain in 1975. During the 1980s, Zara initiated "instant fashions" via a new design, manufacturing, and distribution process that dramatically reduced lead times for new trends. The new process made greater use of information technology and designers worked in teams rather than as individuals.

Zara grew rapidly. The company started expanding throughout Europe in the 1980s and to the United States in 1989. In 2014, Zara adopted a chip technology that allows the company to quickly take inventory via radio signals. The stockroom is notified when an item is sold so the item can be immediately replaced. Zara has nearly perfected a fast-response operation. Just four weeks are needed to design a new product and get finished goods into stores, compared with up to six months for other clothing retailers. It launches about 12,000 new designs each year. Shortening the product cycle means greater success responding to changing customer tastes.

Zara also responds quickly to concerns from customers and others in the environment. Zara received criticism for selling a small child's T-shirt that a customer said closely resembled uniforms worn by concentration camp inmates. Zara immediately removed the shirt and apologized. Greenpeace started a dialogue with Zara about toxic chemicals from clothing production. Zara committed to eradicating hazardous chemicals from its supply chain, becoming the largest retailer to raise awareness for the Greenpeace Detox Campaign and switching to toxic-free production.[37]

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Zara and many other organizations have entire departments charged with monitoring the external environment and finding ways to adapt to or influence that environment.

Through all of these activities, organizations create value for their owners, customers, and employees. Managers analyze which parts of the operation create value and which parts do not; a company can be profitable only when the value it creates is greater than the cost of resources.

Finally, organizations must cope with and accommodate today's challenges of workforce diversity and growing concerns over sustainability and ethics, as well as find effective ways to motivate employees to work together to accomplish organizational goals.

REMEMBER THIS

- Organizations are open systems that obtain inputs from the external environment, add value through a transformation process, and discharge products and services back to the environment.
- Many types of organizations exist. One important distinction is between for-profit businesses, in which managers direct their activities toward earning money for the company, and nonprofit organizations, in which managers direct their efforts toward generating some kind of social impact. A newer kind of organization, the hybrid, does both at the same time.
- Organizations are highly important, and managers are responsible for shaping organizations to perform well and meet the needs of society.

1.4 Dimensions of Organization Design

Organizations shape our lives, and well-informed managers can shape organizations. The first step for understanding organizations is to examine the features that describe specific organizational design traits. These features describe organizations in much the same way that personality and physical traits describe people.

Exhibit 1.3 illustrates two types of interacting features of organizations: structural dimensions and contingency factors. **Structural dimensions** provide labels to describe the internal characteristics of an organization. They create a basis for measuring and comparing organizations. **Contingency factors** encompass larger elements that influence structural dimensions, including the organization's size, technology, environment, culture, and goals. Contingency factors describe the organizational setting that influences and shapes the structural dimensions. Contingency factors can be confusing because they represent both the organization and the environment. These factors can be envisioned as a set of overlapping elements that shape an organization's structure and work processes, as illustrated in Exhibit 1.3. To understand and evaluate organizations, one must examine both structural dimensions and contingency factors.[38] These features of organization design interact with one another and can be adjusted to accomplish the purposes listed earlier in Exhibit 1.2.

1.4a Structural Dimensions

Key structural dimensions of organizations include formalization, specialization, hierarchy of authority, complexity, and centralization.[39]

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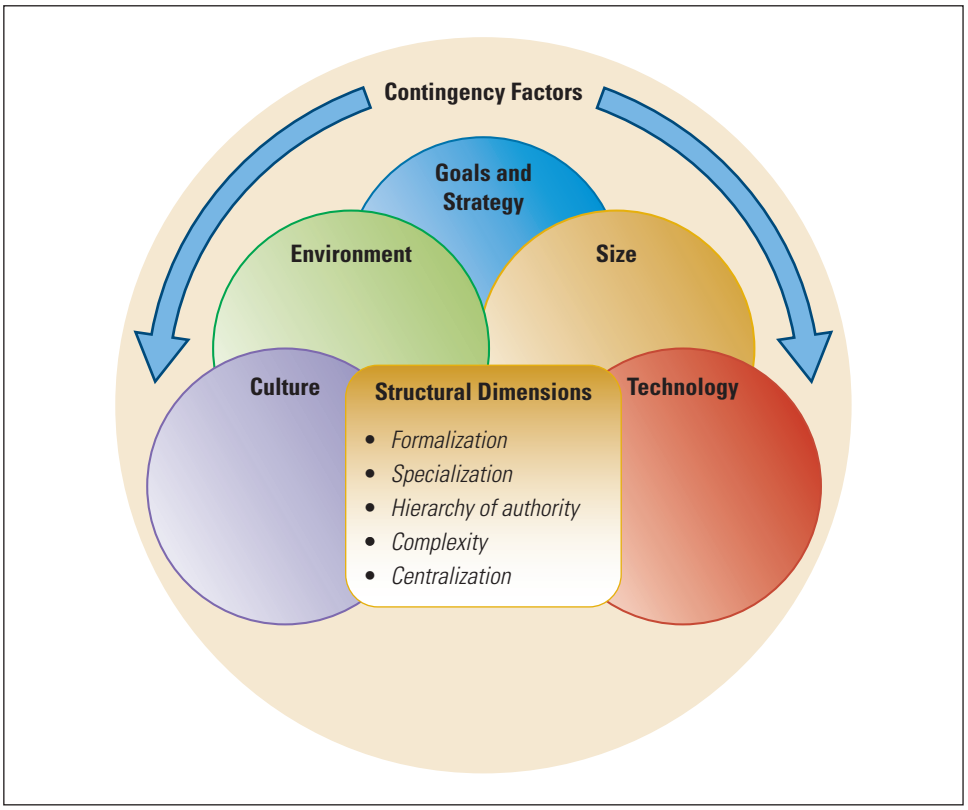

EXHIBIT 1.3
Interacting Structural Dimensions of Design and Contingency Factors

1. *Formalization* pertains to the amount of written documentation in the organization. Documentation includes procedures, job descriptions, regulations, and policy manuals. These written documents describe behavior and activities. Formalization is often measured by simply counting the number of pages of documentation within the organization. Large universities, for example, tend to be high on formalization because they have several volumes of written rules for such things as registration, dropping and adding classes, student associations, dormitory governance, and financial assistance. A small, family-owned business, in contrast, may have almost no written rules and would be considered informal.
2. *Specialization* is the degree to which organizational tasks are subdivided into separate jobs. If specialization is extensive, each employee performs only a narrow range of tasks. If specialization is low, employees perform a wide range of tasks in their jobs. Specialization is sometimes referred to as the *division of labor*.
3. *Hierarchy of authority* describes who reports to whom and the span of control for each manager. The hierarchy is depicted by the vertical lines on an organization chart, as illustrated in Exhibit 1.4. The hierarchy is related to *span of control* (the number of employees reporting to a supervisor). When spans of control are narrow, the hierarchy tends to be tall. When spans of control are wide, the hierarchy of authority will be shorter.
4. *Complexity* refers to the number of distinct departmental units or activities within the organization. For example, GE was incredibly complex. Complexity can be measured along three dimensions: vertical, horizontal, and spatial.

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BRIEFCASE

As an organization manager, keep these guidelines in mind:

Think of the organization as a means to an end. It is a way to organize people and resources to accomplish a specific purpose. Describe the organization according to its degree of formalization, specialization, centralization, complexity, and hierarchy. Look at contingency factors of size, technology, the environment, goals and strategy, and the organizational culture.

Vertical complexity is the number of levels in the hierarchy. Different organizational levels possess different stores of knowledge and expertise.[40] Horizontal complexity is the number of departments or occupational specialties existing horizontally across the organization. Spatial complexity is the degree to which an organization's departments and personnel are dispersed geographically. The organization in Exhibit 1.4 has a vertical complexity of five levels. Its horizontal complexity at level 3 would be seven departments. Spatial complexity would be 1 since the offices are all in the same location.

5. *Centralization* refers to the hierarchical level that has authority to make decisions. When decision making is kept at the top level, the organization is centralized. When decisions are delegated to lower organizational levels, it is decentralized. Examples of organizational decisions that might be centralized or decentralized include purchasing equipment, establishing goals, choosing suppliers, setting prices, hiring employees, and deciding marketing territories. Jack Welch worked to decentralize GE.

To understand the importance of paying attention to structural dimensions of organization design, consider the following examples.

IN PRACTICE

Shizugawa Elementary School Evacuation Center and BP Transocean Deepwater Horizon Oil Rig

One newspaper reporter described Japan as "a rule-obsessed nation with a penchant for creating bureaucracy, designating titles and committees for even the most mundane of tasks." When the fishing village of Minamisanriku was ravaged by a tsunami, that propensity served a valuable purpose. The creation of rules, procedures, and authority structures helped create a sense of normalcy and comfort at the Shizugawa Elementary School Evacuation Center, for example. The group of evacuees created six divisions to oversee various aspects of daily life, such as cooking, cleaning, inventory control, and medical care, and each function had detailed rules and procedures to follow. The exhaustive and meticulous procedures kept the Center running smoothly and helped people cope with a devastating situation.

Contrast that smooth operation to what happened after a Transocean oil rig drilling a well for oil giant BP at Deepwater Horizon exploded in the Gulf of Mexico, killing 11 crew members and setting off an environmental disaster. Setting aside the question of what caused the explosion in the first place, once it happened the structure aboard the rig exacerbated the situation. Activities were so loosely organized that no one seemed to know who was in charge or what their level of authority and responsibility was. Twenty-three-year-old Andrea Fleytas issued a mayday (distress signal) over the radio when she realized no one else had done so, but she was chastised for overstepping her authority. One manager said he didn't call for help because he wasn't sure he had authorization to do so. Still another said he tried to call to shore but was told the order needed to come from someone else. Crew members knew the emergency shutdown needed to be triggered, but there was confusion over who had the authority to give the OK. "The scene was very chaotic," said worker Carlos Ramos. "There was no chain of command. Nobody in charge."[41]

1.4b Contingency Factors

Understanding structural dimensions alone does not help us understand or appropriately design organizations. It is also necessary to look at contingency factors, including size, organizational technology, the external environment, goals and strategy, and organizational culture.

1. *Size* can be measured for the organization as a whole or for specific components, such as a plant or division. Because organizations are social systems, size

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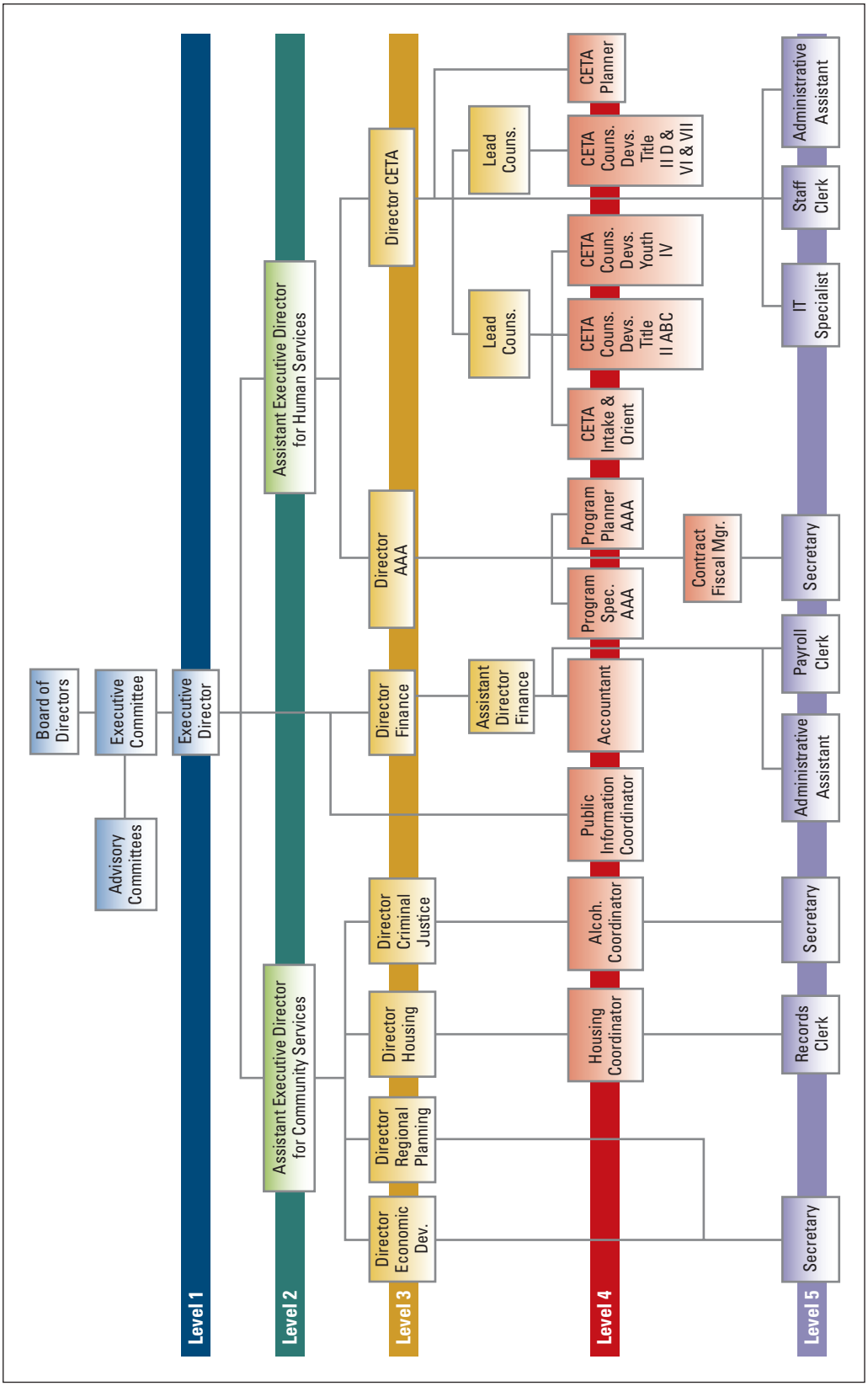
EXHIBIT 1.4
Organization Chart Illustrating the Hierarchy of Authority for a Community Job Training Program



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is typically measured by the number of employees. Other measures such as total sales or total assets also reflect magnitude, but they do not indicate the size of the human part of the system. GE was very large, with hundreds of thousands of employees.

2. *Organizational technology* refers to the tools, techniques, and actions used to transform inputs into outputs. It concerns how the organization actually produces the products and services it provides for customers and includes such things as flexible manufacturing, digital information systems, and the Internet. An automobile assembly line, a social media platform, a college classroom, a ride-hailing app, and an overnight package delivery system are technologies, although they differ from one another.
3. The *environment* includes all elements outside the boundary of the organization. Key elements include the industry, government, customers, suppliers, and the financial community. The environmental elements that affect an organization the most are often other organizations.
4. The organization's *goals and strategy* define the purpose and competitive techniques that set it apart from other organizations. Goals are often written down as an enduring statement of company intent. A strategy is the plan of action that describes resource allocation and activities for dealing with the environment and for reaching the organization's goals. Goals and strategies define the scope of operations and the relationship with employees, customers, and competitors.
5. An organization's *culture* is the underlying set of key values, beliefs, understandings, and norms shared by employees. These underlying values and norms may pertain to ethical behavior, commitment to employees, efficiency, or customer service, and they provide the glue to hold organization members together.[42] At GE, for example, Jack Welch implemented Work-Out sessions to create a culture of open and direct conversation among employees and managers.

The five structural dimensions and five contingency factors discussed here are interdependent. Certain contingency factors will influence the appropriate degree of specialization, formalization, and so forth for the organization. For example, large organization size, a routine technology, and a stable environment all tend to create an organization that has greater formalization, specialization, and centralization. More detailed relationships among contingency factors and structural dimensions are explored throughout this book.

ASSESS YOUR ANSWER

1 An organization can be understood primarily by understanding the people who make it up.

ANSWER: *Disagree.* An organization has distinct characteristics that are independent of the nature of the people who make it up. All the people could be replaced over time while an organization's structural dimensions and contingency factors would remain similar.

The organizational features illustrated in Exhibit 1.3 provide a basis for measuring and analyzing characteristics that cannot be seen by the casual observer, and they reveal significant information about an organization. Consider, for example, the dimensions of Valve Software compared with those of Walmart.

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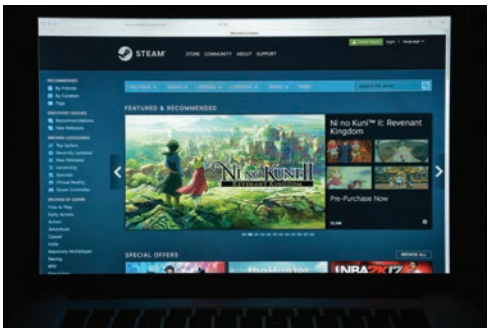

Casimiro/Alamy Stock Photo

IN PRACTICE
Valve Software

Valve Software Corporation, the maker of classic games such as Counter-Strike, Half-Life, Left 4 Dead, Portal, and the popular digital distribution platform Steam, has been "boss free since 1996," as its website proclaims. Valve's unique organization structure caused a minor media blitz after someone posted the employee handbook online a few years ago, but Valve has been functioning smoothly without bosses since it was founded. Co-founders Gabe Newell and Mike Harrington, former Microsoft employees, wanted to create a flat, fast organization that allowed employees maximum flexibility. It sounds like a dream for employees, but many people don't adapt to the "no-structure structure" and leave for more traditional jobs. At Valve, everyone has a voice in making important decisions. Any employee can participate in hiring decisions, which are usually made by teams. There are no promotions, only new projects, with someone emerging as the de facto leader. Firings are rare, but teams decide together if someone isn't working out. Team meetings are highly informal and people are invited to share feelings as well as business ideas.

Compare Valve's approach to that of Walmart, which achieves its competitive edge through internal cost efficiency. A standard formula is used to build each store, with uniform displays and merchandise. Walmart's administrative expenses are the lowest of any chain. The distribution system is a marvel of efficiency. Goods can be delivered to any store in less than two days after an order is placed. Stores are controlled from the top, although store managers have some freedom to adapt to local conditions. Employees follow standard procedures set by management and have little say in decision making. However, performance is typically high, and most employees consider that the company treats them fairly.[43]

Exhibit 1.5 illustrates several structural dimensions and contingency factors of Valve Software and Walmart. Valve is a small organization that ranks very low with respect to formalization and centralization and has a medium degree of specialization. Horizontal collaboration to serve customers with innovative products is emphasized over the vertical hierarchy. Walmart is much more formalized, specialized, and centralized, with a strong vertical hierarchy. Efficiency is more important than new products and services, so most activities are guided by standard regulations. Rules are dictated from the top and communication flows down a strong vertical chain of command.

Structural dimensions and contingency factors can thus tell a lot about an organization and about differences among organizations. These various organization design features are examined in more detail in later chapters to determine the appropriate level of each structural dimension needed to perform effectively based on various contingency factors.

1.4c Performance and Effectiveness Outcomes

The whole point of understanding structural dimensions and contingency factors is to design the organization in such a way as to achieve high performance and effectiveness. Managers adjust various aspects of the organization to most efficiently

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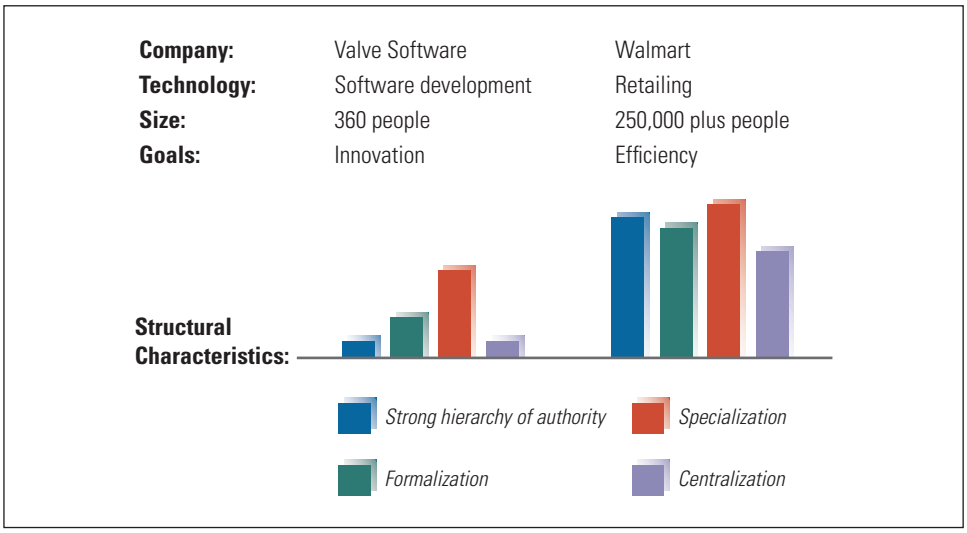
EXHIBIT 1.5
Differing Characteristics of Two Organizations



and effectively transform inputs into outputs and provide value. **Efficiency** refers to the amount of resources used to achieve the organization's goals. It is based on the quantity of raw materials, money, and employees necessary to produce a given level of output. **Effectiveness** is a broader term, meaning the degree to which an organization achieves its goals.

Defining goals and measuring the organization's progress toward attaining them is the most common way managers assess effectiveness. For example, at GE, described in the opening case, Jeff Immelt set new goals for sustainability, as well as goals in other areas, such as innovation and global growth. A small hardware store might set weekly sales goals. In a manufacturing company, managers might set specific targets in areas such as conformity-to-specifications quality, flexibility (both product mix and volume), and speed and timeliness of delivery.[44] To be effective, all organizations need clear, focused goals and appropriate strategies for achieving them. The concept of effectiveness, including goals and strategies and various approaches to measuring effectiveness, will be discussed in detail in Chapter 2.

An alternative approach to measuring effectiveness, the **stakeholder approach**, assesses diverse organizational activities by looking at what various organizational stakeholders want from the organization, and the satisfaction level of each. A **stakeholder** is any group within or outside of the organization that has a stake in the organization's outcomes. Examples of stakeholders include:

- *Customers,* who want high quality products and services provided in a timely manner at a reasonable price.
- *Employees,* who want adequate pay and benefits, good working conditions, and appropriate supervision.
- *Stockholders,* who want a good financial return on their investment.

Managers carefully balance the needs and interests of various stakeholders in setting goals and striving for effectiveness. The satisfaction level of each group can be assessed as an indication of the organization's performance.[45] The stakeholder approach will be discussed in detail in Chapter 7.

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2 The primary role of managers in business organizations is to achieve maximum efficiency.

ASSESS YOUR ANSWER

ANSWER: *Disagree*. Efficiency is important, but organizations must respond to a variety of stakeholders, who may want different things from the organization. Managers strive for both efficiency and effectiveness in trying to meet the needs and interests of stakeholders. Effectiveness is often considered more important than efficiency.

REMEMBER THIS

- Structural dimensions and contingency factors provide labels for measuring and analyzing an organization. These characteristics may vary widely from organization to organization.
- Structural dimensions include formalization, specialization, hierarchy of authority, complexity, and centralization.
- Contingency factors include size, organizational technology, environment, goals and strategy, and culture.
- Managers strive to design organizations to achieve both efficiency and effectiveness.
- Defining clear goals and measuring progress toward achieving them is the most common approach to measuring effectiveness.

1.5 The Evolution of Organization Design

Organization design is not a collection of facts; it is a way of thinking about organizations and how people and resources are organized to collectively accomplish a specific purpose.[46] Organization design is a way to see and analyze organizations more accurately and deeply than one otherwise could. The way to see and think about organizations is based on patterns and regularities in organizational design and behavior. Organization scholars search for these regularities, define them, measure them, and make them available to the rest of us. The facts from the research are not as important as the general patterns and insights into organizational functioning gained from a comparative study of organizations. Insights from organization design research can help managers improve organizational efficiency and effectiveness, as well as strengthen the quality of organizational life.[47] One area of insight is how organization design and management practices have varied over time in response to changes in the larger society.

1.5a Historical Perspectives

You may recall from an earlier management course that the modern era of management theory began with the classical management perspective in the late nineteenth and early twentieth century. The emergence of the factory system during the Industrial Revolution posed problems that earlier organizations had not encountered. As work was performed on a much larger scale by a larger number of workers, people

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began thinking about how to design and manage work in order to increase productivity and help organizations attain maximum efficiency. The classical perspective, which sought to make organizations run like efficient, well-oiled machines, is associated with the development of hierarchy and bureaucratic organizations and remains the basis of much of modern management theory and practice. In this section, we will examine the classical perspective, with its emphasis on efficiency and organization, as well as other perspectives that emerged to address new concerns, such as employee needs and the role of the environment. Elements of each perspective are still used in organization design, although they have been adapted and revised to meet changing needs. These different perspectives can also be associated with different ways in which managers think about and view the organization, called manager frame of reference. Complete the questionnaire in the "How Do You Fit the Design?" box to understand your frame of reference.

Efficiency Is Everything. Pioneered by Frederick Winslow Taylor, **scientific management** emphasizes scientifically determined jobs and management practices as the way to improve efficiency and labor productivity. Taylor proposed that workers "could be retooled like machines, their physical and mental gears recalibrated for better productivity."[48] He insisted that management itself would have to change and emphasized that decisions based on rules of thumb and tradition should be replaced with precise procedures developed after careful study of individual situations.[49] To use this approach, managers develop precise, standard procedures for doing each job, select workers with appropriate abilities, train workers in the standard procedures, carefully plan work, and provide wage incentives to increase output.

Taylor's approach is illustrated by the unloading of iron from railcars and reloading finished steel for the Bethlehem Steel plant in 1898. Taylor calculated that with correct movements, tools, and sequencing, each man was capable of loading 47.5 tons per day instead of the typical 12.5 tons. He also worked out an incentive system that paid each man $1.85 per day for meeting the new standard, an increase from the previous rate of $1.15. Productivity at Bethlehem Steel shot up overnight. These insights helped to establish organizational assumptions that the role of management is to maintain stability and efficiency, with top managers doing the thinking and workers doing what they are told.

The ideas of creating a system for maximum efficiency and organizing work for maximum productivity are deeply embedded in our organizations. A *Harvard Business Review* article discussing innovations that shaped modern management put scientific management at the top of its list of 12 influential innovations.[50]

How to Get Organized. Another subfield of the classical perspective took a broader look at the organization. Whereas scientific management focused primarily on the technical core—on work performed on the shop floor—**administrative principles** looked at the design and functioning of the organization as a whole. For example, Henri Fayol proposed 14 principles of management, such as "each subordinate receives orders from only one superior" (unity of command) and "similar activities in an organization should be grouped together under one manager" (unity of direction). These principles formed the foundation for modern management practice and organization design.

The scientific management and administrative principles approaches were powerful and gave organizations fundamental new ideas for establishing high productivity and increasing prosperity. Administrative principles in particular contributed to the development of **bureaucratic organizations**, which emphasized designing and

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HOW DO YOU FIT THE DESIGN?

EVOLUTION OF STYLE

This questionnaire asks you to describe yourself. For each item, give the number "4" to the phrase that best describes you, "3" to the item that is next best, and on down to "1" for the item that is least like you.

1. My strongest skills are:
- ___ **a.** Analytical skills
- ___ **b.** Interpersonal skills
- ___ **c.** Political skills
- ___ **d.** Flair for drama

2. The best way to describe me is:
- ___ **a.** Technical expert
- ___ **b.** Good listener
- ___ **c.** Skilled negotiator
- ___ **d.** Inspirational leader

3. What has helped me the most to be successful is my ability to:
- ___ **a.** Make good decisions
- ___ **b.** Coach and develop people
- ___ **c.** Build strong alliances and a power base
- ___ **d.** Inspire and excite others

4. What people are most likely to notice about me is my:
- ___ **a.** Attention to detail
- ___ **b.** Concern for people
- ___ **c.** Ability to succeed in the face of conflict and opposition
- ___ **d.** Charisma

5. My most important leadership trait is:
- ___ **a.** Clear, logical thinking
- ___ **b.** Caring and support for others
- ___ **c.** Toughness and aggressiveness
- ___ **d.** Imagination and creativity

6. I am best described as:
- ___ **a.** An analyst
- ___ **b.** A humanist
- ___ **c.** A politician
- ___ **d.** A visionary

Scoring: Compute your scores according to the following rating. The higher score represents your way of viewing the organization and will influence your management style.

Structure = 1a + 2a + 3a + 4a + 5a + 6a = _____
Human Resource = 1b + 2b + 3b + 4b + 5b + 6b = _____
Political = 1c + 2c + 3c + 4c + 5c + 6c = _____
Symbolic = 1d + 2d + 3d + 4d + 5d + 6d = _____

Interpretation: Organization managers typically view their world through one or more mental frames of reference. (1) The *structural frame* of reference sees the organization as a machine that can be economically efficient, with vertical hierarchy and routine tasks that give a manager the formal authority to achieve goals. This managerial way of thinking became strong during the era of scientific management when efficiency was everything. (2) The *human resource frame* sees the organization as its people, with managerial emphasis given to support, empowerment, and belonging. This managerial way of thinking gained importance after the Hawthorne Studies. (3) The *political frame* sees the organization as a competition for scarce resources to achieve goals, with managerial emphasis on building agreement among diverse groups. This managerial way of thinking reflects the need for organizations to share information, have a collaborative strategy, and have all parts working together. (4) The *symbolic frame* sees the organization as theater, with managerial emphasis on symbols, vision, culture, and inspiration. This managerial way of thinking is important for managing an adaptive culture in a learning organization.

Which frame reflects your way of viewing the world? The first two frames of reference—structural and human resource—are important for newer managers at the lower and middle levels of an organization. These two frames usually are mastered first. As managers gain experience and move up the organization, they should acquire political and collaborative skills (Chapter 13) and also learn to use symbols to shape cultural values (Chapter 10). It is important for managers not to be stuck in one way of viewing the organization because their progress may be limited.

Source: Roy G. Williams and Terrence E. Deal, *When Opposites Dance: Balancing the Manager and Leader Within* (Palo Alto, CA: Davies-Black, 2003), 24–28. Reprinted with permission.

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managing organizations on an impersonal, rational basis through such elements as clearly defined authority and responsibility, formal recordkeeping, and uniform application of standard rules. Although the term *bureaucracy* has taken on negative connotations in today's organizations, bureaucratic characteristics worked extremely well for the needs of the Industrial Age. One problem with the classical perspective, however, is that it failed to consider the social context and human needs.

What About People? Early work on industrial psychology and human relations received little attention because of the prominence of scientific management. However, a major breakthrough occurred with a series of experiments at a Chicago electric company, which came to be known as the **Hawthorne Studies**. Interpretations of these studies at the time concluded that positive treatment of employees improved their motivation and productivity. The publication of these findings led to a revolution in worker treatment and laid the groundwork for subsequent work examining treatment of workers, leadership, motivation, and human resource management. These human relations and behavioral approaches added new and important contributions to the study of management and organizations.

However, the hierarchical system and bureaucratic approaches that developed during the Industrial Revolution remained the primary approach to organization design and functioning well into the 1980s. In general, this approach worked well for most organizations until the past few decades. During the 1980s, though, it began to cause problems. Increased competition, especially on a global scale, changed the playing field.[51] North American companies had to find a better way.

Can Bureaucracies Be Flexible? The 1980s produced new corporate cultures that valued lean staff, flexibility and learning, rapid response to the customer, engaged employees, and quality products. Organizations began experimenting with teams, flattened hierarchies, and participative management approaches. For example, in 1983, a DuPont plant in Martinsville, Virginia, cut management layers from eight to four and began using teams of production employees to solve problems and take over routine management tasks. The new design led to improved quality, decreased costs, and enhanced innovation, helping the plant be more competitive in a changed environment.[52] Rather than relying on strict rules and hierarchy, managers began looking at the entire organizational system, including the external environment.

Since the 1980s, organizations have undergone even more profound and far-reaching changes. Flexible approaches to organization design have become prevalent. Recent influences on the shifting of organization design include the Internet and other advances in information technology and big data analytics; globalization and the increasing interconnection of organizations; the rising educational level of employees and their growing quality-of-life expectations; and the growth of knowledge- and information-based work as primary organizational activities.[53]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Be cautious when applying something that works in one situation to another situation. All organizational systems are not the same. Use organization design concepts to identify the correct structure and management systems for each organization.

1.5b It All Depends: Key Contingencies

Many problems occur when all organizations are treated as similar, which was the case with scientific management and administrative principles that attempted to design all organizations alike. The structures and systems that work in the retail division of a conglomerate will not be appropriate for the manufacturing division. The organization charts and financial procedures that are best for an entrepreneurial Internet firm like Instagram will not work for a large food processing plant at Oscar Mayer or a large nonprofit organization such as United Way.

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A basic premise of this text is that effective organization design means understanding various contingencies and how organizations can be designed to fit contingency factors. Contingency factors include organization size, technology, environment, goals and strategy, and organizational culture, as defined previously and shown in Exhibit 1.3. **Contingency** means that one thing depends on other things, and for organizations to be effective there must be a "goodness of fit" between their design and various contingency factors.[54] What works in one setting may not work in another setting. There is no "one best way." Contingency theory means *it depends*. For example, a government agency may experience a certain environment, use a routine technology, and desire efficiency. In this situation, a management approach that uses bureaucratic control procedures, a hierarchical structure, and formalized communications would be appropriate. Likewise, free-flowing design and management processes work best in a high-tech company that faces an uncertain environment with a non-routine technology. The correct approach is contingent on the organization's situation. In the following section, we examine two fundamental approaches to organization design, along with the typical contingency factors associated with each approach.

3 A CEO's top priority is to make sure the organization is designed correctly.

ANSWER: *Agree.* Top managers have many responsibilities, but one of the most important is making sure the organization is designed correctly. Organization design organizes and focuses people's work and shapes their response to customers and other stakeholders. Managers consider both structural dimensions and contingency factors as well as make sure the various parts of the organization work together to achieve important goals.

ASSESS YOUR ANSWER

REMEMBER THIS

- Organization design perspectives have varied over time and managers can understand organizations better by gaining a historical perspective.
- Many problems occur when all organizations are treated as alike, which is the case with some historical design perspectives. Effective organization design also requires understanding various contingencies.
- Contingency means that one thing depends on other things, and for organizations to be effective there must be a "goodness of fit" between their design and their contingency factors, such as size, technology, environment, goals and strategy, and culture.

1.6 The Contrast of Organic and Mechanistic Designs

Organizations can be categorized along a continuum ranging from a mechanistic design to an organic design. Tom Burns and G. M. Stalker first used the terms *organic* and *mechanistic* to describe two extremes of organization design after

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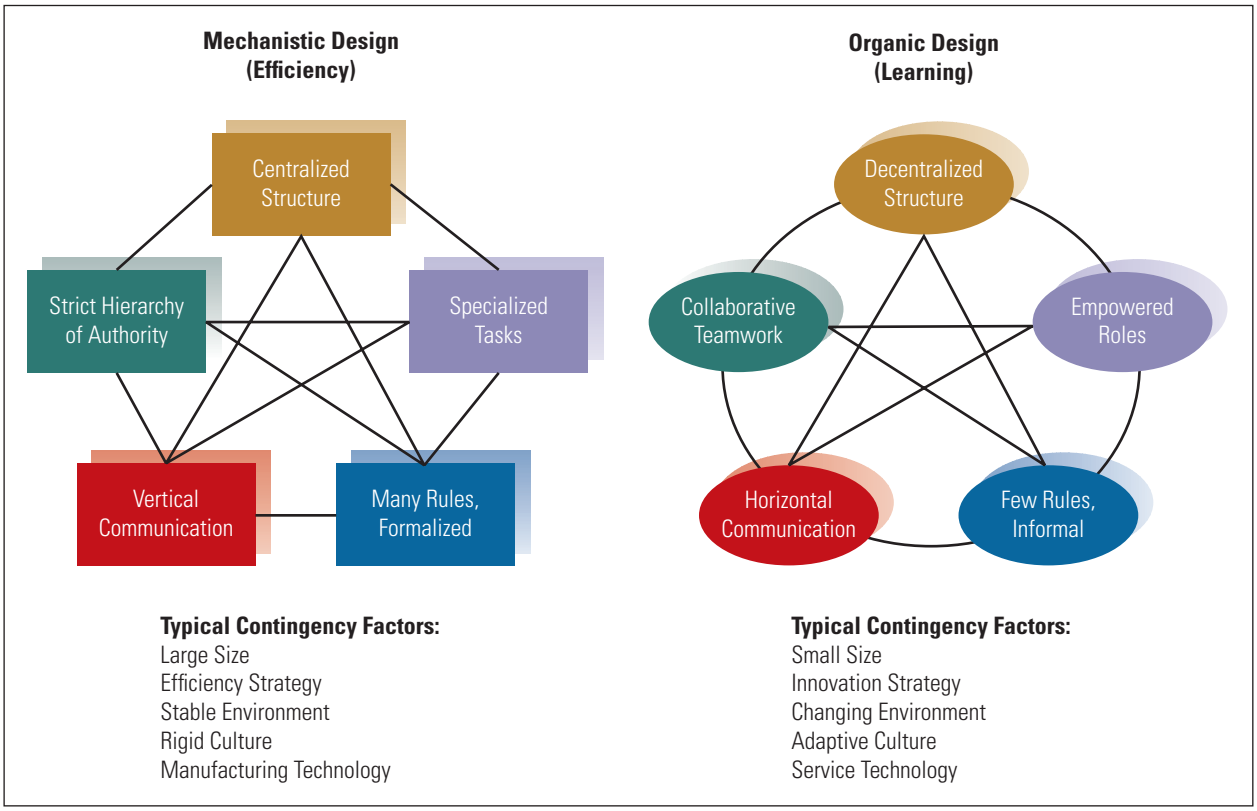
EXHIBIT 1.6
The Contrast of Organic and Mechanistic Designs



observing industrial firms in England.[55] In general, a **mechanistic** design means that the organization is characterized by machine-like standard rules, procedures, and a clear hierarchy of authority. Organizations are highly formalized and are also centralized, with most decisions made at the top. A mechanistic design is concerned primarily with efficiency. An **organic** design means that the organization is much looser, free-flowing, and adaptive. Rules and regulations often are not written down or, if written down, are loosely applied. People may have to find their own way through the system to figure out what to do. The hierarchy of authority is looser and not clear-cut. Decision-making authority is decentralized. The organic design is concerned primarily with learning and adaptation. Managers communicate a clear sense of direction and purpose and then empower employees at all levels. Knowledge and information are widely shared, and challenging the status quo is encouraged.[56] Various contingency factors will influence whether an organization is more effective with a primarily mechanistic or a primarily organic design. Exhibit 1.6 summarizes the differences in organic and mechanistic designs based on five elements: structure, tasks, formalization, communication, and hierarchy. The exhibit also lists the typical contingency factors associated with each type of design.

- *Centralized Versus Decentralized Structure.* Centralization and decentralization pertain to the hierarchical level at which decisions are made. In a mechanistic design, the structure is centralized, whereas an organic design uses

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Think about whether the organization should have a mostly mechanistic design (associated with large size, efficiency strategy, a stable environment, a rigid culture, and a manufacturing technology) or a mostly organic design (associated with smaller size, innovation strategy, a changing environment, an adaptive culture, and a service technology).

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decentralized decision making. **Centralization** means that decision authority is located near the top of the organizational hierarchy. Knowledge and control of activities are centralized at the top of the organization, and employees are expected to do as they are told. With **decentralization**, decision-making authority is pushed down to lower organizational levels. In a highly organic organization, knowledge and control of activities are located with employees rather than with supervisors or top executives. People are encouraged to take care of problems by working with one another and with customers, using their discretion to make decisions.

- *Specialized Tasks Versus Empowered Roles*. A **task** is a narrowly defined piece of work assigned to a person. With a mechanistic design, tasks are broken down into specialized, separate parts, as in a machine, with each employee performing activities according to a specific job description. A **role**, in contrast, is a part in a dynamic social system. A role has discretion and responsibility, allowing the person to use his or her judgment and ability to achieve an outcome or meet a goal. In an organization with an organic design, employees play a role in the team or department and roles may be continually redefined or adjusted.
- *Formal Versus Informal Systems*. With a mechanistic design, there are numerous rules, regulations, and standard procedures. Formal systems are in place to manage information, guide communication, and detect deviations from established standards and goals. With an organic design, on the other hand, there are few rules or formal control systems. Communication and information sharing are informal.
- *Vertical Versus Horizontal Communication*. Mechanistic organizations emphasize vertical communication up and down the hierarchy. Top managers pass information downward to employees about goals and strategies, job instructions, procedures, and so forth, and in turn ask that employees provide information up the hierarchy concerning problems, performance reports, financial information, suggestions and ideas, and so forth. In an organic organization, there is greater emphasis on horizontal communication, with information flowing in all directions within and across departments and hierarchical levels. The widespread sharing of information enables all employees to have complete information about the company so they can act quickly. In addition, organic organizations maintain open lines of communication with customers, suppliers, and even competitors to enhance learning capability.
- *Hierarchy of Authority Versus Collaborative Teamwork*. In organizations with a mechanistic design, there is a close adherence to vertical hierarchy and the formal chain of command. Work activities are typically organized by common function from the bottom to the top of the organization and there is little collaboration across functional departments. The entire organization is controlled through the vertical hierarchy. An organic design, on the other hand, emphasizes collaborative teamwork rather than hierarchy. Structure is created around horizontal workflows or processes rather than departmental functions, with people working across department and organizational boundaries to solve problems. Organic design thus encourages *intrapreneurship,* so that people across the organization are coming up with and promoting new ideas that respond to needs of customers.[57] Self-directed teams are the fundamental work unit in highly organic organizations.

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REMEMBER THIS

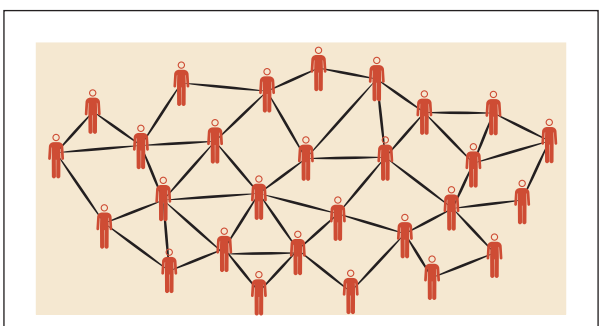
- Organization designs fall on a scale ranging from mechanistic to organic. Various contingency factors will influence whether an organization is more effective with a primarily mechanistic or a primarily organic design.
- A mechanistic design is characterized by a centralized structure, specialized tasks, formal systems, vertical communication, and a strict hierarchy of authority and is associated with contingency factors such as large size, an efficiency strategy, a stable environment, manufacturing technology, and a rigid culture.
- An organic design is characterized by a decentralized structure, empowered roles, informal systems, horizontal communication, and collaborative teamwork and is associated with small size, a learning and innovation strategy, a changing environment, service technology, and an adaptive culture.
- Challenges in today's environment are causing many organizations to shift to more organic designs, although mechanistic characteristics are still valuable for some situations.

1.7 The Emerging Bossless Design Trend

To some extent, organizations are still imprinted with the hierarchical, formalized, mechanistic approach that arose in the nineteenth century with Frederick Taylor. Yet current challenges require greater flexibility for most organizations.[58] One issue pushing the trend toward extreme decentralization is the growth of knowledge-based work, where ideas and expertise are the primary sources of value creation. In a knowledge-based organization, managers rarely have all the expertise needed to solve problems or create the products and services the organization needs to succeed. People at all levels must be continually contributing ideas. The need for rapid response as the environment or customer needs change quickly, and the ability to share information throughout the company with information technology are other factors leading to greater decentralization. When everyone has access to the information they need and the training to make good decisions, having layers of managers just eats up costs and slows down response time.

A few organizations have shifted to an extremely organic, "bossless" design.[59] In a bossless company, there are typically no job titles, no seniority, and no managers or executives. People work together on an equal basis, as illustrated in the visual in Exhibit 1.7 and described previously in the example of Valve. A few bossless work environments, such as W. L. Gore and the French company FAVI, have existed for decades, and this has become a real trend in recent years. Many bossless companies, such as Valve, Netflix (video streaming and rentals),

EXHIBIT 1.7
Everyone Is Nearly Equal in a Bossless Organization Design



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and Peakon (human resources and employee engagement software) are in technology-related industries, but companies as diverse as GE Aviation (aviation manufacturing), W. L. Gore & Associates (best known for Gore-Tex fabrics), Whole Foods (supermarkets), and Semco (diversified manufacturing) have succeeded with bossless structures. Morning Star provides one of the most interesting examples of a bossless work environment.

IN PRACTICE
Morning Star

Many people are surprised to learn that the world's largest tomato processor is a company that has no titles or promotions, no hierarchy, and no managers. Morning Star, where 400 or so employees (called colleagues) produce over $700 million a year in revenue, relies on contract-style agreements called Colleague Letters of Understanding (CLOUs). If a colleague needs an expensive piece of equipment to fulfil her CLOU, she can buy it without seeking permission. Similarly, if someone needs an additional worker, he can go ahead and hire one. Founder Chris Rufer organized Morning Star based on the principles of self-management:

- No one has a boss
- Employees negotiate responsibilities with their peers
- Everyone can spend the company's money
- There are no titles or promotions
- Compensation is decided by peers

How does such a system work? As the company grew from the original 24 colleagues to around 400, problems occurred. Some people had trouble working in an environment with no bosses and no hierarchy. Thus, Rufer created the Morning Star Self-Management Institute to provide training for people in the principles and systems of self-management. Every colleague now goes through training, in groups of 10 to 15 people, to learn the skills of how to work effectively as part of a team, how to handle the responsibilities of "planning, organizing, leading, and controlling" that were formerly carried out by managers, how to balance freedom and accountability, how to understand and effectively communicate with others, and how to manage conflicts. "Around here," one colleague said, "nobody's your boss and everybody's your boss."[60]

In a bossless work environment such as that at Morning Star, nobody gives orders, and nobody takes them. Accountability is to the customer and the team rather than to a manager. There can be many advantages to a bossless work environment, including increased flexibility, greater employee initiative and commitment, and better, faster decision making.[61] However, bossless work environments also present new challenges. Costs may be lower because of reduced overhead, but money has to be invested in ongoing training and development for employees so they can work effectively within a bossless system and manage themselves. The culture also must engage employees and support the non-hierarchical environment.

REMEMBER THIS

- Current challenges require greater flexibility and decentralization for most organizations.
- Some organizations have shifted to an extremely organic, "bossless" design.
- Bossless work environments present challenges such as the need for ongoing training and development and a culture that engages employees.

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1.8 Framework for the Book

How does a course in organization design differ from a course in management or organizational behavior? The answer is related to the concept called *level of analysis*.

1.8a Levels of Analysis

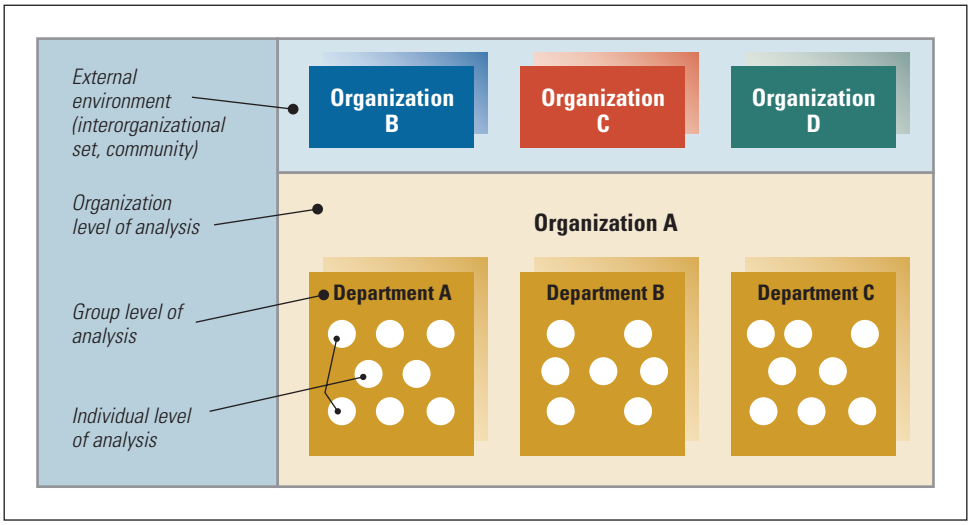
Each organization is a system that is composed of various subsystems. Organization systems are nested within systems, and one **level of analysis** has to be chosen as the primary focus. Four levels of analysis normally characterize organizations, as illustrated in Exhibit 1.8. The individual human being is the basic building block of organizations. The human being is to the organization what a cell is to a biological system. The next higher system level is the group or department. These are collections of individuals who work together to perform group tasks. The next level of analysis is the organization itself. An organization is a collection of groups or departments that combine into the total organization.

Organizations themselves can be grouped together into the next higher level of analysis, which is the interorganizational set and community. The inter-organizational set is the group of organizations with which a single organization interacts. Other organizations in the community make up an important part of an organization's environment.

Organization design focuses on the organizational level of analysis, but with concern for groups and the environment. To explain the organization, one should look not only at its characteristics but also at the characteristics of the environment and of the departments and groups that make up the organization. The focus of this book is to help you understand organizations by examining their specific characteristics, the nature of and relationships among groups and departments that make up the organization, and the collection of organizations that make up the environment.

Are individuals included in organization design? Organization design does consider the behavior of individuals, but in the aggregate. People are important, but

EXHIBIT 1.8
Levels of Analysis in Organizations



Source: Based on Andrew H. Van De Ven and Diane L. Ferry, *Measuring and Assessing Organizations* (New York: Wiley, 1980), 8; and Richard L. Daft and Richard M. Steers, *Organizations: A Micro/Macro Approach* (Glenview, IL: Scott, Foresman, 1986), 8.

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they are not the primary focus of analysis. Organization design is distinct from organizational behavior.

Organizational behavior is the micro approach to organizations because it focuses on the individuals within organizations as the relevant units of analysis. Organizational behavior examines concepts such as motivation, leadership style, and personality and is concerned with cognitive and emotional differences among people within organizations.

Organization theory and design is a macro examination of organizations because it analyzes the whole organization as a unit. Organization design is concerned with people aggregated into departments and organizations and with the differences in structure and behavior at the organization level of analysis. Organization design might be considered the sociology of organizations, while organizational behavior is the psychology of organizations.

Organization design is directly relevant to top- and middle-management concerns and partly relevant to lower management. Top managers are responsible for the entire organization and must set goals, develop strategy, interpret the external environment, and decide organization structure and design. Middle management is concerned with major departments, such as marketing or research, and must decide how the department relates to the rest of the organization. Middle managers must design their departments to fit work-unit technology and deal with issues of power and politics, intergroup conflict, and information and control systems, each of which is part of organization theory and design. Organization design is only partly concerned with lower management because this level of supervision is concerned with employees who operate machines, create services, or sell goods. Organization design is concerned with the big picture of the organization and its major departments.

BRIEFCASE

As an organization manager, keep this guideline in mind:

Make yourself a competent, influential manager by using the frameworks that organization design provides to interpret and understand the organization around you.

1.8b Plan of the Book

The topics within the field of organization design are interrelated. Chapters are presented so that major ideas unfold in logical sequence. The framework that guides the organization of the book is shown in Exhibit 1.9. Part 1 introduces the basic idea of organizations as social systems and the essential concepts of organization design. This discussion provides the groundwork for Part 2, which is about strategic management, goals and effectiveness, and the fundamentals of organization structure. This section examines how managers help the organization achieve its purpose, including the design of an appropriate structure, such as a functional, divisional, matrix, or horizontal structure. Part 3 looks at the various open system elements that influence organization structure and design, including the external environment, interorganizational relationships, the global environment, and designing for social impact.

Parts 4 and 5 look at processes inside the organization. Part 4 describes how organization design is related to the contingency factors of manufacturing and service technology, and organizational size and life cycle. Part 5 shifts to dynamic processes that exist within and between major organizational departments and includes topics such as innovation and change, culture and control, decision-making processes, managing intergroup conflict, and power and politics.

1.8c Plan of Each Chapter

Each chapter begins with opening questions to immediately engage the student in the chapter content. Theoretical concepts are introduced and explained in the body of the

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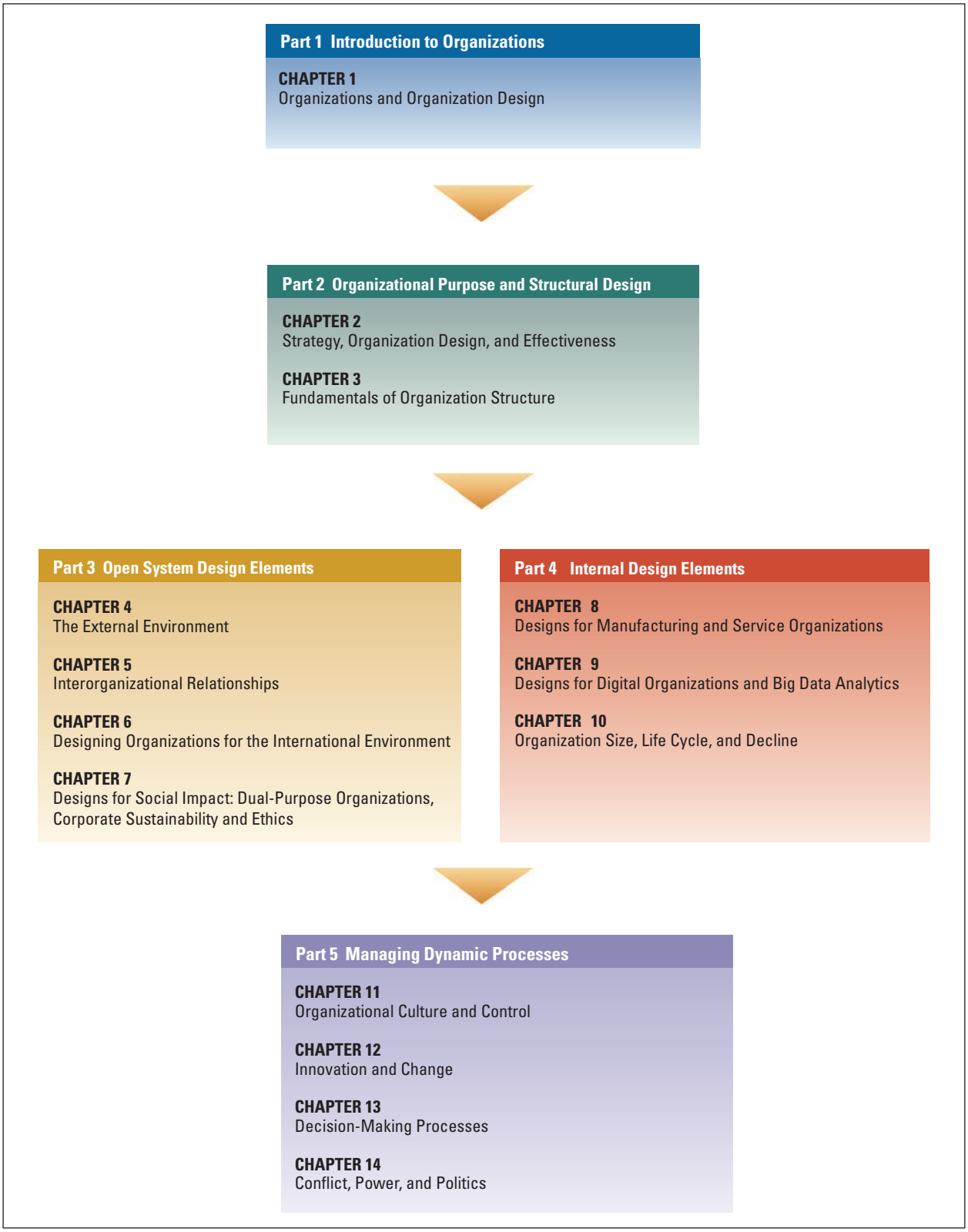
EXHIBIT 1.9
Framework for the Book



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chapter. Several *In Practice* segments are included in each chapter to illustrate the concepts and show how they apply to real organizations. Each chapter also contains a *How Do You Fit the Design?* questionnaire that draws students more deeply into a particular topic and enables them to experience organization design issues in a personal way. A *BookMark* is included in each chapter to present organizational issues that today's managers face in the real world. These short book reviews discuss current concepts and applications to deepen and enrich the student's understanding of organizations. The examples and book reviews illustrate the dramatic changes taking place in management thinking and practice. Key points for designing and managing organizations are highlighted in the *Briefcase* items throughout the chapter. A *Remember This* section at the end of each major section reviews and explains important theoretical concepts.

REMEMBER THIS

- Organization theory and design is a macro examination of organizations because it analyzes the whole organization as a unit.
- Most concepts in organization theory and design pertain to the top- and middle-management levels of the organization. This book is concerned more with the topics of those levels than with the operational-level topics of supervision and motivation of employees, which are discussed in courses on organizational behavior.

KEY CONCEPTS

administrative principles
big data analytics
bureaucratic organizations
centralization
contingency factors
contingency
decentralization
effectiveness
efficiency
Hawthorne Studies
level of analysis
mechanistic
open system
organic
organization theory and design
organizational behavior
organizations
role
scientific management
stakeholder
stakeholder approach
structural dimensions
task

DISCUSSION QUESTIONS

1. What is one contingency factor that might help explain the poor performance of GE when Jeffrey Immelt was CEO? Explain.
2. Describe some ways in which the digitalization of business has influenced or affected an organization with which you are familiar, such as your college or university, a local retailer or restaurant, a volunteer organization, a club to which you belong, or even your family. Can you identify both positive and negative aspects of this influence?
3. A handful of companies on the *Fortune* 500 list are more than 100 years old, which is rare. What organizational characteristics do you think might explain 100-year longevity?
4. Can an organization be efficient without being effective? Can an inefficient organization still be an effective one? Explain your answers.
5. What is the difference between formalization and specialization? Do you think an organization high on one dimension would also be high on the other? Discuss.
6. What does *contingency* mean? What are the implications of contingency theory for managers?
7. What are the primary differences between an organic and a mechanistic organization design? Which type of organization do you think would be easier to manage? Discuss.
8. What does it mean to say an organization is an open system? How is the stakeholder approach related to the concept of open systems?

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9. What are some differences one might expect for measuring effectiveness expectations for a nonprofit organization versus a for-profit business? Do you think nonprofit managers have to pay more attention to stakeholders than do business managers? Discuss.

10. Early management theorists believed that organizations should strive to be logical and rational, with a place for everything and everything in its place. Discuss the pros and cons of this approach for organizations today.

CHAPTER 1 WORKSHOP Measuring Dimensions of Organizations

Individually or in a small group of two, interview two employees who are in different organizations or who are in the same organization but in different parts and doing different jobs. Ask each person to answer the following questions on a four-point scale from Definitely False, Mostly False, Mostly True, Definitely True. You will be asked to analyze the patterns of scores for the two respondents.

Formalization	Definitely False	Mostly False	Mostly True	Definitely True
1. There is a written description for my job.	_____	_____	_____	_____
2. There is a chart showing where people are in the hierarchy.	_____	_____	_____	_____
3. There is a written record of each person's job performance.	_____	_____	_____	_____
4. There is a written document that tells what to do in a crisis.	_____	_____	_____	_____
5. We have written procedures here for most situations.	_____	_____	_____	_____

Formalization Score _____. (Sum questions 1 to 5 giving four points for each Definitely True, three points for each Mostly True, two points for each Mostly False, and one point for each Definitely False.)

Centralization	Definitely False	Mostly False	Mostly True	Definitely True
6. A person who works in this job cannot expect to make all his or her own decisions.	_____	_____	_____	_____
7. Any decision I make has to have my boss's approval.	_____	_____	_____	_____
8. Even small matters are typically referred to someone higher up for a decision.	_____	_____	_____	_____
9. I participate in the decision to hire staff at my level.	_____	_____	_____	_____
10. How things are done here is left up to the person doing the work.	_____	_____	_____	_____

Centralization Score _____. (Sum questions 6 to 8, giving four points for each Definitely True, three points for each Mostly True, two points for each Mostly False, and one point for each Definitely False. *Reverse score* items 9 and 10, giving one point for each Definitely True, two points for each Mostly True, three points for each Mostly False, and four points for each Definitely False.)

Technology (Work Variety)	Definitely False	Mostly False	Mostly True	Definitely True
11. My job has new things happening every day.	_____	_____	_____	_____
12. One thing around here is the high variety of work.	_____	_____	_____	_____
13. There is something different to do here every day.	_____	_____	_____	_____
14. The work here is very routine.	_____	_____	_____	_____
15. People like me do about the same job in the same way most of the time.	_____	_____	_____	_____

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Technology Score _____. (Sum questions 11 to 13, giving four points for each Definitely True, three points for each Mostly True, two points for each Mostly False, and one point for each Definitely False. *Reverse score* items 14 and 15, giving one point for each Definitely True, two points for each Mostly True, three points for each Mostly False, and four points for each Definitely False.)

Questions

1. What are the main differences between the three scores for the two people you interviewed?
2. Do you notice any patterns in the three scores, such as a higher score on one characteristic is associated with a higher or lower score on another characteristic?
3. Which of the interviewees seemed more satisfied in their work? Do you think satisfaction is related to their scores on formalization, centralization, and technology? Explain.

CASE FOR ANALYSIS | Craft Originalities, Inc.

Craft Originalities, Inc. was started by an entrepreneur named Bradley (Bibby) Burnett in rural Alabama. After a variety of failed attempts at self-employment, Bibby began to have some success making wooden toys in 1981. During the next few years, he put his efforts into making a collection of 15 toys and selling them via direct mail and some TV advertising. He had no sales representatives. One day a visiting salesperson offered to take on Bibby's line of toys, which was the start of using outside sales representatives to sell his product line. He never did hire an in-house salesperson, relying instead on outside companies that specialized in selling to retail outlets.

Bibby's first attempt at a tradeshow was successful. His last-minute entry into a regional gift show brought home $30,000 in sales. Unfortunately, he lacked the money to produce the toys, until a friend made him a loan. He acquired two old buildings on a nearby farm and started a small manufacturing shop. He and his wife started visiting all available tradeshows as a way to build business. Sales reached $150,000 in 1984, $300,000 in 1985, $500,000 in 1987, and over $1 million in 1988, doubling almost every year. In 1990 Bibby moved Craft Originalities, Inc. into a newer 60,000 square-foot building. Sales continued to increase through the mid-1990s, with total sales passing $15 million. By 2004 sales boomed to almost $70 million and then started leveling off.

By 2007, although sales were steady, the financial situation at Craft Originalities was tight. The company now occupied two 60,000 square foot buildings and had almost 800 employees. A second shift was in operation, but Bibby could see that production was generally inefficient. Then the 2007—2008 financial crisis hit, and sales dropped sharply. By 2010, the sharp decline in sales had stopped but the sales picture was still bad, and inventory space was maxed out with finished goods. Inventory tied up capital, so Craft Originalities added to the layoffs that had started in 2009.

At this point Bibby realized that he needed help. He had managed the fast growth period of his company, but he was older now and managing the decline seemed beyond his experience. He decided to ask his son Bob Burnett to run the business. Bob had not wanted to be part of the business when he graduated from college, so he had worked his way up in an auto parts manufacturer. Bob decided to replace Bibby as CEO of Craft Originalities, Inc.

The company was in critical condition. Sales had dropped off and there were losses or no profits for three years. The number of employees fell from 800 to about 550. Bob Burnett realized how bad things were: "When I took over, sales were running 30 percent off and we could not get credit from our suppliers. We were on a cash-only basis. Inventory was still high, accounts receivable were taking four months or more for us to collect, and manufacturing did not have a superintendent to oversee the operation." The situation looked grim. Bob was also unhappy with the low quality of company foremen and managers. Many positions were filled with his father's and mother's relatives and friends. There were no professional managers. Even the office area and accounting seemed informal and casual, not like a business should be run. Everything done informally without standardization reflected his dad's personality and leadership style. There were no policies and few written rules and regulations covering things like safety or vacations. When a big decision needed to be made, people went to Bibby. Key decisions reflected Bibby's free-form personality. This approach worked for many years, but it was not working now. The organization chart for Craft Originalities is shown in Exhibit 1.10.

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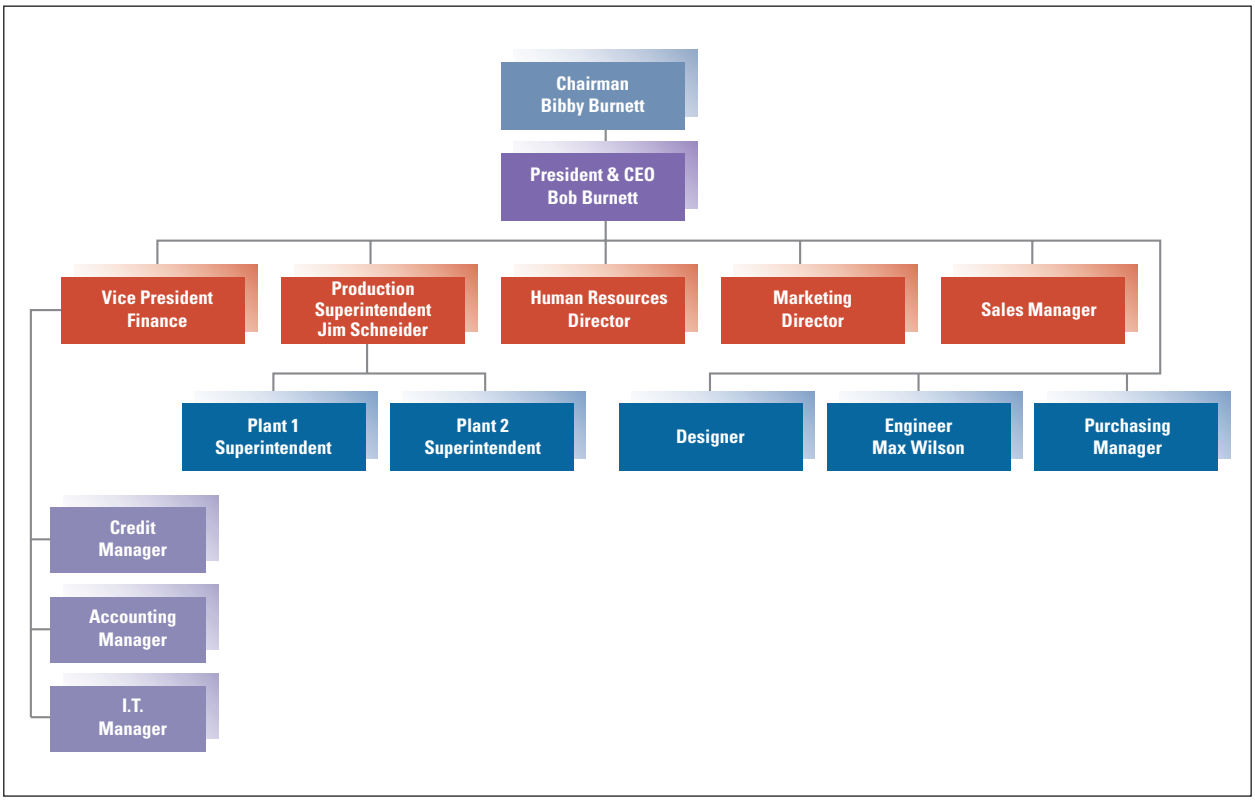
EXHIBIT 1.10
Organization Chart for Craft Originalities, Inc., 2012



Marketing

Craft Originalities was one of four companies that accounted for about 60 percent of sales of wooden decorative products in the Southeastern United States. Sales were seasonal, peaking with Christmas, and doing well at Easter and Thanksgiving, with steady sales at a lower rate the rest of the year. The product line now consisted of over 800 items and included almost anything a customer could want. The largest item was a tea-cart and the smallest a clothespin-type desk paper clip. New products were developed at a rate of about 50 per year based on items Bibby saw at trade shows and would copy. Practically no items were dropped because there was no precise data on individual product sales or profit. Bob estimated that the top 250 products sold over 1,000 units a year. Bob wanted to spend most of his time on marketing. He attended all trade shows and learned firsthand what competitors were doing and what customers were buying. He felt the outside sales reps had not kept Craft Originalities informed about what was changing in the market. The Sales Manager was responsible for coordinating new products with the companies for whom the external sales representatives worked and for dealing with customer complaints or exchanges.

Bob decided to hire a local woman with good design talent to set up a design department. She soon came up with a new theme line of items that was very popular at trade shows and became the talk of the industry. He asked the marketing manager to engage a New York advertising agency for a professional program of advertising and publicity. Bob also applied an immediate price increase in an effort to end the year with a profit.

Production

There were two production plants within a 10-mile radius. Kiln dry lumber, mainly high-quality Ponderosa pine, was inventoried in truck trailers and covered sheds at the rear of each plant. The lumber sizes seemed totally random, dependent on the tree. The lengths ranged from 8 to 16 feet and the thickness ranged from 3/8" to 6/8".

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The rough mill (raw lumber processed into useful pieces) foreman reviewed the batch of production orders he was given each week and decided on the "panels" of wood the plant would need. A panel is a sheet of wood milled to a desired thickness and with length and width dimensions needed for specific products. The necessary panels would be made in the rough mill from lumber or obtained by purchasing glued panels from vendors. Craft Originalities spent about as much on purchased panels as it did on raw lumber, paying about twice as much for a square-foot of panel as for a square-foot of lumber. Employees in the Surfacing department worked the wood to the desired thickness for the final product, which was the finished dimension plus some excess for sanding. Ripsaws cut the lumber to the needed width and cut-off saws took care of the length.

The plant superintendent worked with the machine room foreman to decide on the sequence in which orders would be processed. Scheduled due-dates for each department were written on the orders by the production control supervisor, who followed up on the actual flow of orders only if a crisis developed in the machine room, where workers shaped panels into the final form. The tools in the machine room included shapers, molders, routers, and borers, which required some skill to master. Work that used patterns and jigs lowered the skill requirements, although still needing skills that were higher than for most jobs in the plant. This part of the plant was the noisiest and dustiest.

In the third department, sanding, the wood pieces were sanded by women working mainly at individual stations. The sanded components were moved to a nearby temporary storage area on carts, which originated at machining. There were six to eight wooden parts in an average item. In addition, there were purchased items such as glass or metal parts.

The assembly foreman checked on the arrival of all parts for an order. Assembly began when all parts were available. Workers assembled the items using glue, screws, nail guns, or hammer and nails. Jigs assisted the work where possible, and usually only one person worked on an order. Little skill was needed for assembly, and dust and noise were not a problem in this area.

The assembled items moved to the separate finishing area. Here they were dipped by hand into stains and sprayed with several clear coats. After oven drying, the items proceeded to packing. Most items were packed individually into cartons made in the company's separate small plant. Finishing and packing employed about 50 people. The new finished goods warehouse was two miles away.

Most jobs did not require high skill levels. The average jobs in the rough mill and machine room, where the skilled jobs were located, required no more than five weeks to master because the workers usually had developed some skills in previous positions. Elsewhere in the plants, a week of training was usually adequate. Everyone but the supervisors and workers considered the work pace quite slow.

Production Problems

Bob felt that production efficiency was a major problem. From talking with machinery salespeople and other visitors to the plant, he believed the machinery was generally adequate. Based on what he knew about competitors' operations, he felt his labor cost must be reduced. His initial attempts to work with the plant superintendents and the various supervisors to systematically speed up output met with no success. The supervisors saw no need to identify improvements in the plant or to develop techniques for bringing about more efficiency. To help the supervisors begin to improve their operations, Bob scheduled a weekly production meeting starting in June 2010. At the meeting the supervisors were to examine the total dollar output and total costs for each plant for the past week, compare it to the labor goal of 32 percent, which was set by Bob, and think about what could be done to improve operations. Unfortunately, good data on each department's performance were not available. The plant superintendent and his supervisors volunteered no ideas about what specifically limited last week's output. Bob persisted and some discussion of problems began after about three months. Bob's opinion was that this kind of thinking and planning was not required under his father's management. The supervisors in general felt nothing was wrong in the plant and seemed puzzled at the thought of doing anything except continuing what they had always done. They had no experience working in other plants.

In March of 2011, after a good deal of thought and search, Bob hired two college-educated employees to help with the production system. The first was Jim Schneider, age 38, who was hired to be general superintendent over everyone in production in both plants, replacing the current superintendent, who went back to his previous job as a foreman. The other, Max Wilson, age 27, was to be manufacturing engineer. It appeared to Bob that the plant simply needed better management rather than any single big change that could be purchased from the outside. Both new people were college trained in business and engineering and had work experience in the wood industry.

Bob expected some resistance to the new hires from the replaced superintendent and most of the supervisors. The new hires were briefed on this problem. As expected, the change did not advance smoothly. Complaints and rumors were frequent, and Bob ignored them to the extent possible. However, after three months with the new people in place, the complaints persisted and—perhaps more importantly—the new superintendent did not appear to have command of people in the plants. He had not

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developed an assessment of what needed to be changed and had no comprehensive plan for improvement. Bob also saw evidence that Jim had some major difficulties supervising people. One of the supervisors who did not appear to be part of the rumor campaign and was conscientiously concerned about the company, gave Bob examples of the new superintendent's mistakes. Bob felt that he may have made a mistake hiring Jim. Max's responsibilities had narrowed to mostly technical tasks. He was supervising the five-person repair crew, engineering some new products, examining procedures for producing samples of new products, and beginning to examine a major redesign of the rough mill area.

Major Competitor

Craft Originalities' major regional competitor was Saint Crafters, Inc. A manager of outside sales reps who was familiar with both Craft Originalities and Saint Crafters provided a comparison of the two companies to Bob. Demand for Saint Crafters' products exceeded their capacity, and the overflow demand, in this person's opinion, was the main reason Craft Originalities existed. Saint Crafters had no debt and its equipment was described as new. The company was located in a small community where the workers were highly skilled for this kind of business. The manager characterized the average Originalities worker as about two-thirds as capable as Saint Crafters' workers. The quality of manufacture of Saint Crafters' products was considered better than Craft Originalities. Moreover, Saint Crafters' manufacturing superintendent scheduled long runs in manufacturing with the objective of having three months' inventory of top priority items. It sounded like more of a mass production process rather than producing separate small batches for each new order the way Craft Originalities did.

The observer also noted that two-thirds of the equipment at Craft Originalities sat idle at any given time and that neither capacity nor optimum production mix had ever been analyzed. The largest production run he claimed to have seen had been about 250 pieces. The cost of each new setup was notable. He commented that Craft Originalities had the most informal and least structured or systematic operation he had ever seen, with the slowest pace for this type of work. The observer felt that the employees knew only the simplest way of doing a job. Only one person in the company, for example, was able to count the board feet of lumber. He stated that this was a skill that the smallest cabinet shop would have and that it was essential for any kind of usage control.

The Workforce

Bob was interested in newer concepts of management. He frequently referred to the latest book or sent a copy of an article to his managers. The behavioral writings made a lot of sense to him and he was interested in the concept of corporate culture. Participative management systems and teamwork environments were things Bob wanted Craft Originalities to try. However, he recognized his managers and the workforce were not ready for this approach. His managers manipulated more than cooperated, and the workers for the most part were neither highly skilled nor educated. When he discussed the workers' desires with the supervisors, he was told they just wanted a retirement program and higher pay, nothing else. Bob wondered whether this was what the supervisors wanted for themselves.

As a basis for considering a change in management style and culture, Bob contacted a professor from his alma mater and hired him to conduct an employee attitude survey. All employees completed the written questionnaire in small groups. The survey included questions developed specifically to assess the Craft Originalities' culture and employee attitudes. Although the wording was considered simple, when answering open-ended questions several of the workers did not understand words such as "stimulating" or "ambitious," and it sometimes became necessary to read the entire questionnaire to them.

The study showed that minorities accounted for 80 percent of the employees, with white females the largest group at 40 percent. The workforce was 58 percent female, 57 percent white, and 39 percent over 45 years old. Roughly as many people had been with the company under two years as over 10 years. The pay was only a little above the legal minimum, but many workers felt fortunate to have their jobs. There did not appear to be a morale crisis. Many of the questions pertained to aspects of the work culture that could be improved. A few of the statements and answer scores to the closed-ended questions are below. Each question was answered on a scale of 1 = strongly disagree to 5 = strongly agree:

My pay is fair for this kind of job.	2.26
My coworkers are good to work with.	4.14
I enjoy my work.	4.13
Morale is good here.	3.55
I like the way my supervisor treats me.	4.02
My complaints are heard by management.	3.22
The supervisors do a poor job.	2.35

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I am fortunate to have this job.	3.95
Communications are poor.	2.91
I enjoy my work.	4.13
I look for ways to improve my work.	4.21
The company is well run.	3.29

The survey revealed no critical problems. However, the workers were relatively unsophisticated, and Bob was concerned they might not have expressed themselves accurately on the instrument, especially since other people were present and their supervisor may have read the questions to them.

Bob pondered what the survey results meant. He wondered whether there was any need to push ahead with a more participative culture. He still saw the need to improve production efficiency.

Questions

1. Assuming the survey scores are accurate, what conclusions can you draw about Craft Originalities' culture? What is your evidence?
2. If Craft Originalities adopted a mass production manufacturing process similar to its competitor, Saint Crafters, how do you think that would affect the attitude scores of the workers? Explain.
3. How do you think the rural environment might have influenced the lack of formalization and the casual work environment at Craft Originalities? Discuss.

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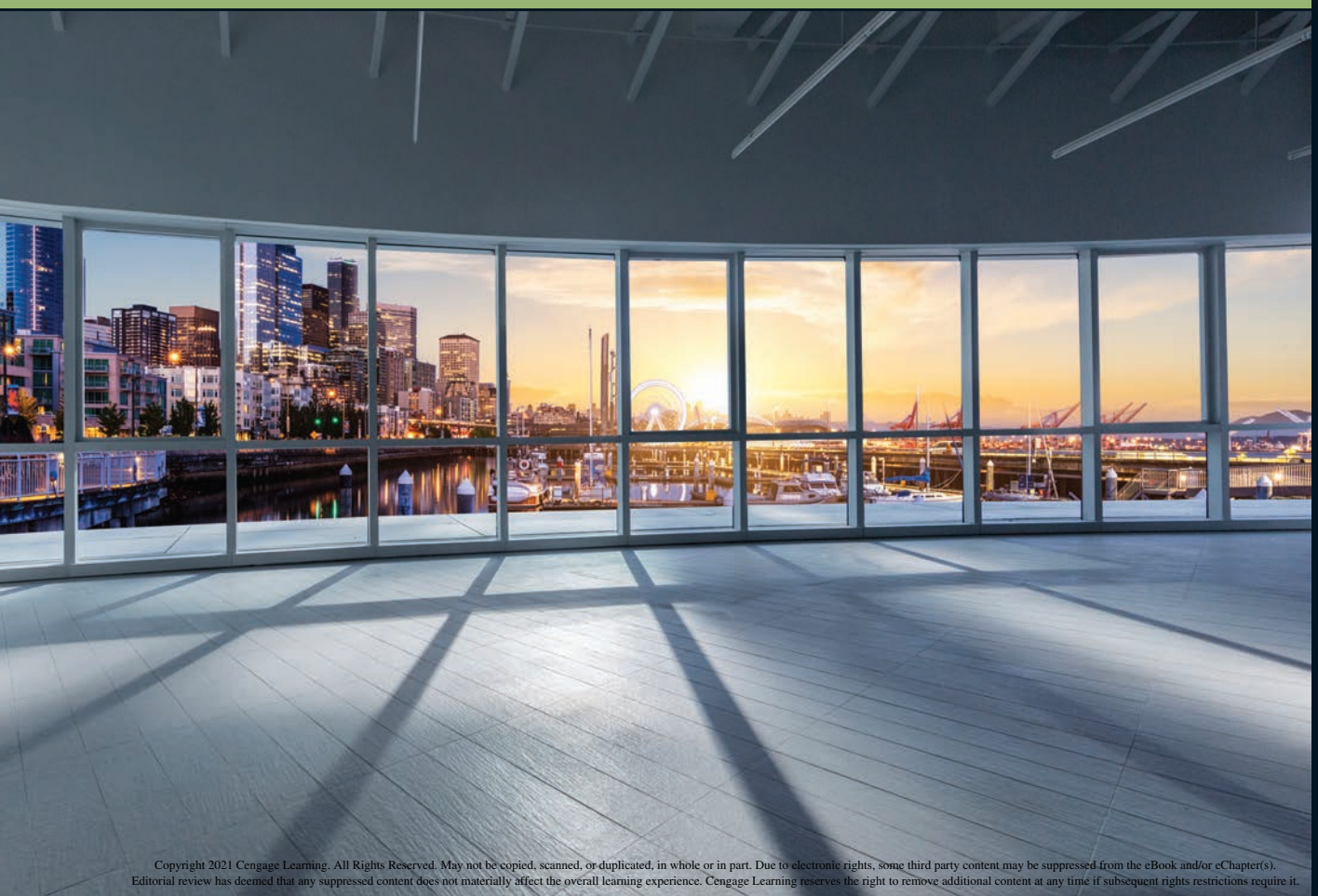
PART 2

Organization Purpose and Structural Design

Chapter 2 Strategy, Organization Design, and Effectiveness

Chapter 3 Fundamentals of Organization Structure



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CHAPTER

2 Strategy, Organization Design, and Effectiveness

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Learning Objectives

After reading this chapter you should be able to:

1. Describe the role of strategy when designing an organization.
2. Describe the key similarities and differences between Porter's strategy model and Miles and Snow's strategy typology.
3. Identify key distinctions among the goal, resource, internal process, and strategic constituents approaches to measuring effectiveness.
4. Explain the competing values model and how it relates to effectiveness.

Chapter Outline

The Role of Strategic Direction in Organization Design

Organizational Purpose

Strategic Intent • Operating Goals • Goal Conflict • The Importance of Goals

Two Frameworks for Selecting Strategy and Design

Porter's Competitive Strategies • Miles and Snow's Strategy Typology • How Strategies Affect Organization Design • Other Contingency Factors Affecting Organization Design

Assessing Organizational Effectiveness

Definition of Organizational Effectiveness • Who Decides? • Goal Approach • Resource-Based Approach • Internal Process Approach • Strategic Constituents Approach

An Integrated Effectiveness Model

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **A company's strategic intent or direction reflects managers' systematic analysis of organizational and environmental factors.**

I AGREE _____ I DISAGREE _____

2 **The best business strategy is to make products and services as distinctive as possible to gain an edge in the marketplace.**

I AGREE _____ I DISAGREE _____

3 **The best measures of business performance are financial.**

I AGREE _____ I DISAGREE _____

Kim Kardashian uses it. So does Donald Trump, Taylor Swift, Michelle Obama, David Beckham, and Queen Elizabeth II. When the Queen made her debut on Instagram in March 2019, the post showcasing her visit to the London Science Museum got more than 57,000 likes within a few hours. The Queen decided it was time she hopped on Instagram, the popular photo and video sharing social platform that had grown to more than a billion active users worldwide. That rapid growth has far outpaced the growth of rival Snapchat, as well as that of Instagram's parent company Facebook. Instagram created a short, lofty mission statement—to capture and share the world's moments—soon after it was acquired by Facebook in 2012, but within a few years, then-CEO Kevin Systrom and his Instagram co-founder Mike Krieger realized they needed help if the company was going to grow and start making money. Enter Marne Levine, who joined Instagram as chief operating officer in 2016. One of Levine's talents is bringing order out of chaos by helping set clear goals. For instance, she discovered that Instagram didn't even have a formal budget, so one of her first tasks was creating a budget so people had guidelines and ways to keep track of spending in their pursuit of goals. Levine also worked with managers to set well-defined goals for hiring employees and creating new products, which has helped Instagram mature from a pell-mell operation into a full-fledged business bringing in billions in revenue.[1]

One of the primary responsibilities of managers is to position their organizations for success by establishing goals and strategies that can keep the organization competitive. Establishing mission, goals, and strategy is the first step for any business to achieve its purpose. Managers have to know where they want the organization to go before they can take it there. When managers don't have clear goals, or have conflicting goals, the organization finds itself in a difficult position and achieving anything may seem improbable. Consider the situation at Yahoo, which had early success on the Internet (it was the most trafficked website in early 2000) but has steadily fallen behind over the past two decades as a succession of CEOs have failed to define a clear direction and purpose for the organization. "If you're everything, you're kind of nothing," said Brad Garlinghouse, a former Yahoo executive, suggesting that Yahoo has been in a slow decline because "it never solved its core identity crisis."[2]

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Purpose of This Chapter

Top managers give direction to organizations. They set goals and develop the plans for their organization to attain them. The purpose of this chapter is to help you understand the types of goals that organizations pursue and some of the competitive strategies managers use to reach those goals. We provide an overview of strategic management, examine two significant frameworks for determining strategic action, and look at how strategies affect organization design. The chapter also describes the most popular approaches to measuring the effectiveness of organizational efforts. To manage organizations well, managers need a clear way to measure how effective the organization is in attaining its goals.

2.1 The Role of Strategic Direction in Organization Design

The choice of goals and strategy influences how an organization should be designed. An **organizational goal** is a desired state of affairs that the organization attempts to reach.[3] A goal represents a result or end point toward which organizational efforts are directed.

Top executives decide the end purpose the organization will strive for and determine the direction it will take to accomplish it. It is this purpose and direction that shapes how the organization is designed and managed. Indeed, *the primary responsibility of top management is to determine an organization's goals, strategy, and design, thereby adapting the organization to a changing environment.*[4] Middle managers do much the same thing for major departments within the guidelines provided by top management. Exhibit 2.1 illustrates the relationships through which top managers provide direction and then design.

The direction-setting process typically begins with an assessment of the opportunities and threats in the external environment, including the amount of change, uncertainty, and resource availability, which we discuss in more detail in Chapter 4. Top managers also assess internal strengths and weaknesses to define the company's distinctive competence compared with other firms in the industry. **SWOT analysis** (in which "SWOT" stands for "strengths, weaknesses, opportunities, and threats") includes a careful assessment of the strengths, weaknesses, opportunities, and threats that affect organizational performance. This competitive analysis of the internal and external environments is one of the central concepts in strategic management. Leaders obtain information about external opportunities and threats from a variety of sources, including customers, government reports, professional journals, suppliers, bankers, friends in other organizations, consultants, and association meetings. Information about internal strengths and weaknesses comes from company budgets, financial ratios, profit and loss statements, and surveys of employee attitudes and satisfaction, among other reports. Executives at The Kroger Company, like those at other grocery retailers, have been dealing with strong and swift changes in the industry in recent years. A brief SWOT analysis can give leaders a guide for how to position the company as it adapts to these changes.

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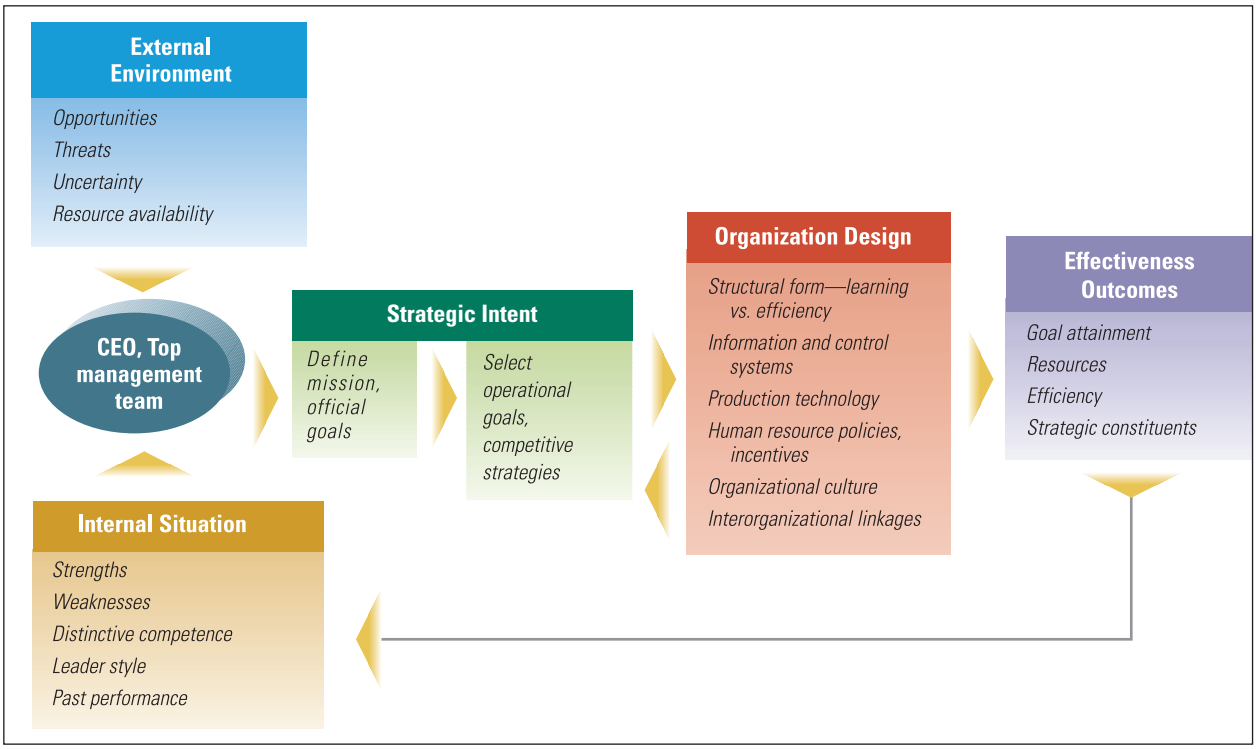
EXHIBIT 2.1

Top Management Role in Organization Direction, Design, and Effectiveness



Source: Adapted from Arie Y. Lewin and Carroll U. Stephens, "CEO Attributes as Determinants of Organization Design: An Integrated Model," *Organization Studies* 15, no. 2 (1994), 183–212.

IN PRACTICE
The Kroger Company

The Kroger Company is the largest supermarket chain in the United States, with around 2,800 stores in 35 states and the District of Columbia. Top executives have been revamping strategy and overhauling operations to adapt to a variety of changes, including increased competition and shifting consumer interests.

One of Kroger's primary *strengths* is the company's broad array of products and services, including groceries, jewelry, fuel, pharmacy services, and home products, that provides one-stop shopping for customers. Kroger also has a strong line of private label brands, and sales of the company's own brands are growing faster than national brands in almost every category. One *weakness* is that the organization has a high debt load on its balance sheet compared to many of its competitors. In addition, falling prices for mainstay products such as eggs, milk, and meats affect Kroger along with other retailers. Leaders identified an *opportunity* to expand the line of organic foods offered in its grocery stores, and to address growing customer concerns over food waste. They found that customers responded favorably to the addition of natural and organic products and that Kroger was able to offer many of them at a lower cost than competitors such as Whole Foods. A significant *threat* is the aggressive expansion of non-traditional rivals such as Walmart, Target, and Amazon into the grocery business.

Kroger leaders are positioning the company to provide consumers with "anything, anytime, anywhere." The company has invested in new technology to launch a direct-to-consumer shipping platform and is expanding home delivery. A merger with Home Chef

(*continued*)

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strengthens Kroger's ability to offer convenience, simplicity, and fresh food solutions. The company is also increasing its offerings of natural and organic products. It expanded its private label brands and introduced the Pickuliar Picks brand, selling "ugly" fruits and vegetables. Selling misshapen or unusual-looking tomatoes, bell peppers, and other produce that would otherwise be thrown out lowers costs for customers and helps Kroger achieve an ambitious goal of zero food waste.[5]

ASSESS YOUR ANSWER

1 A company's strategic intent or direction reflects managers' systematic analysis of organizational and environmental factors.

ANSWER: *Agree.* The best strategies come from systematic analysis of organizational strengths and weaknesses combined with analysis of opportunities and threats in the environment. Careful study combined with experience enables top managers to decide on specific goals and strategies.

A second approach leaders use in setting direction is a forecasting technique known as scenario planning.[6] **Scenario planning** involves looking at current trends and discontinuities and visualizing future possibilities. Rather than looking only at history and thinking about what has been, managers think about what *could be*. The events that cause the most damage to companies are those that no one even conceived of. Managers can't predict the future, but they strengthen their ability to cope with uncertainty by rehearsing a framework within which future events can be managed.[7] Organizations can be disrupted by any number of events. A survey by the Chartered Management Institute and the Business Continuity Institute found that some of the top events for which managers might need scenario plans include extreme weather, loss of IT systems, loss of key employees, loss of access to offices or plants, failure of communications systems, and supply chain disruptions.[8] Scenarios are like stories that offer alternative vivid pictures of what the future will be like and how managers will respond. Typically, two to five scenarios are developed for each set of factors, ranging from the most optimistic to the most pessimistic view. Royal Dutch Shell has long used scenario planning and has been preparing for a world in which oil prices continue to decrease. Scenario planning has helped steer Shell's strategy of moving toward producing fuel for electricity, such as natural gas and renewable sources, and focusing on keeping its costs low.[9]

After direction-setting, the next step, as shown in Exhibit 2.1, is to define and articulate the organization's *strategic intent*, which includes defining an overall mission and official goals based on the correct fit between external opportunities and internal strengths. Leaders then formulate specific operational goals and strategies that define how the organization is to accomplish its overall mission. In Exhibit 2.1, organization design reflects the way goals and strategies are implemented so that the organization's attention and resources are consistently focused toward achieving the mission and goals.

Organization design is the administration and execution of the strategic plan. Managers make decisions about structural form, including whether the organization will be designed primarily for learning and innovation (an organic approach) or to achieve efficiency (a mechanistic approach), as discussed in Chapter 1. Other choices are made about information and control systems, the type of production technology, human resource policies, culture, and linkages to other organizations.

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Changes in structure, technology, human resource policies, culture, and interorganizational linkages will be discussed in subsequent chapters. Also note the arrow in Exhibit 2.1 running from organization design back to strategic intent. This means that strategies are often made within the current structure of the organization so that current design constrains, or puts limits on, goals and strategy. More often than not, however, the new goals and strategy are selected based on environmental needs and then top managers attempt to redesign the organization to achieve those ends.

Finally, Exhibit 2.1 illustrates how managers evaluate the effectiveness of organizational efforts—that is, the extent to which the organization realizes its goals. This chart reflects the most popular ways of measuring performance, each of which is discussed later in this chapter. It is important to note here that performance measurements feed back into the internal environment so that past performance of the organization is assessed by top managers in setting new goals and strategic direction for the future.

Procter & Gamble (P&G) provides an example of how these ideas translate into organization practice. Former CEO A. G. Lafley wanted to provide a framework for organizing the discussion about goals and strategic direction so he used the OGSM (Objectives, Goals, Strategies, and Measures) tool illustrated in Exhibit 2.2. Note

EXHIBIT 2.2
Procter & Gamble's Framework for Strategy Discussion

OBJECTIVES	STRATEGIES	MEASURES

Improve the lives of families by providing consumer-preferred paper products for kitchen and bathroom
Be the operating TSR leader in North American tissue/towel and value creator for P&G
 	
GOALS
Year-on-Year operating TSR> XX%
X% annual share and sales growth
X% annual gross & operating profit margin improvement
X% return on capital investments in plant equipment and inventory
	WHERE TO PLAY:
	• Win in North America
	• Grow Bounty and Charmin margin of leadership
	• Win in supermarket and mass discount channels
	• Build performance, sensory and value consumer segments
	
	HOW TO WIN:
	1. Be lean
	  • Get plant/equipment capital spend to XX of sales
	  • Reduce inventory by XX%
	2. Be the choice of consumers
	  • Superior base products, prices right
	  • Preferred product formats and designs
	  • Manage category growth
	3. Be the choice of retailers
	  • Improve shelf availability and service
	  • Develop differentiated shopping solutions
	  • Win with the winners
		• Operating TSR progress
		• Share and sales growth progress
		• Profit growth progress
		
		Efficiency measures:
		• Capital efficiency
		• Inventory turns
		
		Consumer preference measures:
		• Weighted purchase intent
		• Trial, purchase, and loyalty
		
		Retailer feedback measures:
		• Key business drivers (distribution, share of shelf, share of merchandising, etc.)
		• Preferred vendor

Source: Adapted from A.G. Lafley and Roger Martin, "Instituting a Company-Wide Strategic Conversation at Procter & Gamble," *Strategy & Leadership* 41, no. 4 (2013), 4–9; Table 6.1.

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that a broad objective such as "Be the operating TSR (total shareholder return) leader in North American tissue/towel and value creator for P&G" is translated into more specific goals and strategies, such as "Grow Bounty and Charmin margin."[10] In addition, the chart lists measures that managers will use to determine the success of their efforts. This is the essence of strategic management: setting goals, defining strategies for achieving the goals, and measuring the effectiveness of efforts.

The role of top management is important because managers can interpret the environment differently and develop different goals and strategies. Several years ago, in the midst of a U.S. sales slump, top executives at Walmart tried a new direction. Instead of sticking with goals of strict operational efficiency and everyday low prices, they decided to court upscale customers with remodeled, less cluttered stores, organic foods, and trendy merchandise. Instead of offering everyday low prices, the retailer raised prices on many items and promoted price cuts on select merchandise. Walmart succeeded in meeting its goal of attracting more upscale clientele, but many of its core customers decided they'd start shopping at other discount and dollar store chains. Walmart's sales took a sharp downturn. "I think we tried to stretch the brand a little too far," said William Simon, head of the U.S. division.[11]

The choices top managers make about goals, strategies, and organization design have a tremendous impact on organizational effectiveness. Remember that goals and strategies are not fixed or taken for granted. Top managers and middle managers must select goals for their respective units, and the ability to make good choices largely determines a firm's success. Organization design is used to implement goals and strategy and also determines organization success.

REMEMBER THIS

- Leaders' choices of mission and purpose influence how the organization should be designed and have a tremendous impact on organizational effectiveness.
- Setting a direction for the organization begins with top leaders looking at both the external environment and the organization's internal situation. Two approaches leaders may use in the direction-setting process are SWOT analysis and scenario planning.
- Leaders then define and articulate the organization's strategic intent, which includes defining an overall mission as well as operational goals and strategies for reaching them.
- Goals and strategies help shape how an organization should be designed.

2.2 Organizational Purpose

All organizations, including Instagram, Walmart, Procter & Gamble, Uber, Stanford University, Google, the Catholic Church, the U.S. Department of Agriculture, the local laundry, and the neighborhood deli, exist for a purpose. This purpose may be referred to as the overall goal or mission. Different parts of the organization establish their own goals and objectives to help meet the overall goal, mission, or purpose of the organization.

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2.2a Strategic Intent

Many types of goals exist in organizations, and each type performs a different function. To achieve success, however, organizational goals and strategies are focused with strategic intent. **Strategic intent** means that all the organization's energies and resources are directed toward a focused, unifying, and compelling overall goal.[12] Examples of ambitious goals that demonstrate strategic intent are Microsoft's early goal to "Put a computer on every desk in every home," Komatsu's motto, "Encircle Caterpillar," and Coca-Cola's goal "To put a Coke within 'arm's reach' of every consumer in the world."[13] Strategic intent provides a focus for management action. Three aspects related to strategic intent are the mission, core competence, and competitive advantage.

Mission. The overall goal for an organization is often called the **mission**—the organization's reason for existence. The mission describes the organization's shared values and beliefs and its reason for being. For example, the long-standing mission of Berrett-Koehler Publishers is stated as, "Connecting People and Ideas to Create a World That Works for All." An organization's mission is sometimes called the **official goals**, which refers to the formally stated definition of business scope and outcomes the organization is trying to achieve. Official goal statements typically define business operations and may focus on values, markets, and customers that distinguish the organization. Whether called a mission statement or official goals, the organization's general statement of its purpose and philosophy is often written down in a policy manual or the annual report. Exhibit 2.3 shows the mission statement for CVS Health. CVS defines its mission (or purpose, as shown in the exhibit) as "Helping people on their path to better health." The statement also defines the company's core values.

One of the primary purposes of a mission statement is to serve as a communication tool.[14] The *mission statement* communicates to current and prospective employees, customers, investors, suppliers, and competitors what the organization stands for and what it is trying to achieve. A mission statement communicates legitimacy to internal and external stakeholders, who may join and be committed to the organization because they identify with its stated purpose and values. Most top leaders want employees, customers, competitors, suppliers, investors, and the local community to look on the organization in a favorable light, and the concept of legitimacy plays a critical role. CVS Caremark changed its name to CVS Health and redefined its purpose to reflect a broader healthcare commitment and the company's vision to "drive innovations needed to shape the future of health."[15] CVS, which provides health clinics as well as pharmacy and retail sales, stopped selling cigarettes and other tobacco products in all its stores by October of 2014. For a company involved in promoting health and wellness, managers say, selling tobacco products didn't make sense and hurt the company's reputation. Other pharmacies involved in providing healthcare have also stopped selling tobacco products because of the need to communicate legitimacy.

Companies where managers are sincerely guided by mission statements that focus on a larger social purpose, such as Medtronic's "To restore people to full life and health" or Liberty Mutual's "Helping people live safer, more secure lives," typically attract better employees, have better relationships with external parties, and perform better in the marketplace over the long term.[16]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Establish and communicate organizational mission and goals. Communicate official goals to provide a statement of the organization's mission to external constituents. Communicate operating goals to provide internal direction, guidelines, and standards of performance for employees.

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EXHIBIT 2.3
Mission Statement for CVS Health

CVS Health

Competitive Advantage. The overall aim of strategic intent is to help the organization achieve a sustainable competitive advantage. **Competitive advantage** refers to what sets the organization apart from others and provides it with a distinctive edge for meeting customer or client needs in the marketplace. Strategy necessarily changes over time to fit environmental conditions, and good managers pay close attention to trends that might require changes in how the company operates. Managers analyze competitors and the internal and external environments to find potential *competitive openings* and learn what new capabilities the organization needs to gain the upper hand against other companies in the industry.[17] Competitive openings might be thought of as spaces that a company can potentially fill. This chapter's BookMark describes how organizations can move from competing in "red oceans," crowded markets where companies chew each other up for smaller and smaller chunks of market share, toward "wide open blue oceans," where there is more promise and less competition.

Core Competence. A company's **core competence** is something the organization does especially well in comparison to its competitors. A core competence may be

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in the area of superior research and development, expert technological know-how, process efficiency, or exceptional customer service.[18] Mimeo, an online printing and copying company, for example, excels with core competencies of superb customer service and the application of technology to ensure internal process efficiency. Mimeo can handle rush jobs that larger companies can't. At Apple, strategy focuses on core competencies of superior design and marketing skills.[19] In each case, managers identified what their company does especially well and built the strategy around it.

BOOKMARK 2.0 HAVE YOU READ THIS BOOK?

Blue Ocean Shift: Beyond Competing; Proven Steps to Inspire Confidence and Seize New Growth

By W. Chan Kim and Renée Mauborgne

Almost every book or article you read about strategy focuses on how to outpace rivals, beat the competition, and win at the expense of other companies. That's why there are so many managers and companies out there fighting in the "red ocean" of cutthroat and bloody competition. In their previous book *Blue Ocean Strategy* and their new volume, *Blue Ocean Shift*, W. Chan Kim and Renée Mauborgne take a different approach: *Create a new market where there is less competition*. That is the essence of blue ocean strategy. Kim and Mauborgne's more recent *Blue Ocean Shift* gives managers a roadmap for doing just that.

MAKING THE SHIFT

Kim and Mauborgne's book is based on decades of research into successful and unsuccessful strategic moves spanning more than a hundred years and 30 industries. They describe three components for successfully executing blue ocean strategy.

- *Start with the Right Perspective*. A shift in perspective means recognizing that managers can shape industry conditions and create or expand new markets. They cite powerful real-life examples such as Square, which opened up the credit card market for small businesses and sole proprietors, and French appliance maker Groupe SEB, which established a goal of producing a French fry maker that didn't involve any actual frying.
- *Apply the Right Set of Tools.* Kim and Mauborgne provide a set of market-creating tools, such as "The Three Tiers of Non-Customers," which helps managers identify various levels of people who do not currently patronize the industry in which the company operates.
- *Use a Humanistic Process to Create an Involved Workforce.* The third key component is to ensure that the blue ocean shift recognizes and harnesses the humanity within people, "acknowledging their fears, their insecurities, their need to be treated with dignity, their desire to matter."

MAKING THE PROCESS HUMANISTIC

Without employee contributions and buy-in, the new strategy will fail. A successful blue ocean transformation process recognizes that "each pair of hands comes with a brain and a heart" so it involves people by weaving three humanistic elements throughout the entire journey:

- *Engagement*. Managers actively involve people in the change process. If people aren't involved in the strategic decisions that affect them, the transformation from red to blue ocean strategy could founder from lack of involvement.
- *Explanation*. Managers give people throughout the organization "a clear account of the thinking that underlies the process."
- *Reassurance*. Managers might not adopt all employee ideas and opinions, but they are careful to reassure people "that their opinions have been considered." Providing reassurance also means letting people know what to expect and clarifying their roles and responsibilities in the new blue ocean world.

Blue Ocean Shift, by W. Chan Kim and Renée Mauborgne, is published by Hachette.

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2.2b Operating Goals

The organization's mission and overall goals provide a basis for developing more specific operating goals. **Operating goals** designate the ends sought through the actual operating procedures of the organization and explain what the organization is actually trying to do.[20] Operating goals describe specific measurable outcomes and are often concerned with the short run. Operating goals typically pertain to the primary tasks an organization must perform.[21] For example, one of the critical tasks at technology companies is fixing bugs, but the work is tedious and most programmers prefer designing new features to fixing bugs in current ones. To motivate employees, top leaders at Mozilla Corporation, maker of the Firefox Web browser, gave them two goals: to close 40 high-priority bugs on the browser between February 2017 and the next beta release of Firefox in September, and to bring Mozilla's performance within 20 percent of Chrome's score on a browser benchmarking service. The goals worked! By late August, Mozilla's programmers had closed nearly 400 bugs and were close to the goal of closing the performance gap with rival Chrome.[22]

Specific goals for each primary task provide direction for the day-to-day decisions and activities within departments. Typical operating goals that define what an organization is trying to accomplish include performance goals, resource goals, market goals, employee development goals, productivity goals, and goals for innovation and change, as illustrated in Exhibit 2.4.

Overall Performance. Profitability reflects the overall performance of for-profit organizations. Profitability may be expressed in terms of net income, earnings per share, or return on investment. Other overall performance goals are growth and output volume. Growth pertains to increases in sales or profits over time. Volume pertains to total sales or the number of products or services delivered.

Government and nonprofit organizations such as social service agencies or labor unions do not have goals of profitability, but they do have goals that attempt to specify the delivery of services to clients or members within specified expense levels. The

EXHIBIT 2.4
Typical Operating Goals for an Organization

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Internal Revenue Service has a goal of providing accurate responses to 85 percent of taxpayer questions about new tax laws. Growth and volume goals also may be indicators of overall performance in nonprofit organizations. Expanding their services to new clients is a primary goal for many social service agencies, for example.

Resources. Resource goals pertain to the acquisition of needed material and financial resources from the environment. They may involve obtaining financing for the construction of new plants, finding less expensive sources for raw materials, or hiring top-quality technology graduates. Starbucks formed an alliance with India's Tata Group to obtain Indian premium Arabica coffee beans for use in Starbucks stores. Eventually, the alliance will also enable Starbucks to find prime locations for outlets in India, which can also be considered valuable resources.[23] A new resource goal for Walmart is to hire every veteran who wants a job, provided the person left the military in the previous year and did not have a dishonorable discharge.[24] For nonprofit organizations, resource goals might include recruiting dedicated volunteers and expanding the organization's funding base.

Market. Market goals relate to the market share or market standing desired by the organization. Market goals are largely the responsibility of marketing, sales, and advertising departments. At L'Oreal SA, the world's largest cosmetics company, executives set a goal of adding one billion customers by 2020. As one step to achieve the goal, managers are making changes in marketing and selling approaches designed to win over more customers in Brazil. Women there are some of the biggest spenders on beauty products, but L'Oreal has had trouble adapting to the Brazilian market.[25] Market goals can also apply to nonprofit organizations. Cincinnati Children's Hospital Medical Center, not content with a limited regional role in healthcare, has gained a growing share of the national market by developing expertise in the niche of treating rare and complex conditions and relentlessly focusing on quality.[26]

Employee Development. Employee development pertains to the training, promotion, safety, and growth of employees. It includes both managers and workers. Strong employee development goals are one of the characteristics common to organizations that regularly show up on *Fortune* magazine's list of "100 Best Companies to Work For." Moreover, employee learning goals have been found to be related to higher levels of department performance.[27] Wall Street banks have long been known for encouraging long work hours, but some are now taking a critical look at that hard-charging culture. Bank of America Merrill Lynch (rebranded BofA Securities), for example, issued an internal memo saying junior bankers should have two weekends off a month. To expand employee development, the bank also intends to "make certain that junior bankers work on a wider variety of different assignments . . . and ensure that the development of core skills is an important factor in making staffing assignments."[28]

Productivity. Productivity goals concern the amount of output achieved from available resources. They typically describe the amount of resource inputs required to reach desired outputs and are thus stated in terms of "cost for a unit of production," "units produced per employee," or "resource cost per employee." Illumination Entertainment, the production company behind the hit movie "Hop," has productivity goals that help the company make animated films at about half the cost of those made by larger studios. CEO Christopher Meledandri believes strict cost controls and successful animated films are not mutually exclusive, but it means Illumination's 30 or so employees have to be highly productive.[29]

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Innovation and Change. Innovation goals pertain to internal flexibility and readiness to adapt to rapid changes in the environment. Innovation goals are often defined with respect to the development of specific new services, products, or production processes. Kraft Heinz has been falling behind competitors since leaders cut funding and attention for research and development. After the Brazilian private-equity firm 3G Capital acquired H.J. Heinz and Kraft Foods, executives focused heavily on goals of cost-cutting. There have been some positive results, but weak attention to goals of innovation and change has limited the company's ability to adapt to the shift away from processed foods toward fresher, simpler and more natural products.[30]

Successful organizations use a carefully balanced set of operating goals. For example, some of today's best companies recognize that a single-minded focus on bottom-line profits may not be the best way to achieve high performance. Innovation and change goals are increasingly important, even though they may initially cause a *decrease* in profits. Employee development goals are critical for helping to maintain a motivated, committed workforce.

2.2c Goal Conflict

Organizations perform many activities and pursue many goals simultaneously to accomplish an overall mission. But who decides what mission and goals to strive for? Pursuing some goals means that others have to be delayed or set aside, which means managers often disagree about priorities.[31] Employee development goals might conflict with productivity goals; goals for innovation might hurt profitability. As one real-life example of goal conflict, recent analyses of company operations at Facebook reveal that goals of protecting user privacy and personal data have long been in conflict with goals of growth and increased advertising revenue. While Facebook has publicly presented an idealistic mission of "bringing people together by making the world more open and connected," internal e-mails and other reports reveal a long-standing pattern of exploiting and deceiving users, undermining competitors, strong-arming development partners, and other ruthless and sometimes unscrupulous business practices designed to increase the company's profits. The founders of WhatsApp, Facebook's largest acquisition, left the company because of conflicts with Facebook executives over issues such as data privacy and ways to increase ad revenue.[32]

The Facebook example illustrates that many companies mix value systems and behaviors that represent different sectors of society, which leads to tensions and conflict within the organization over goals and priorities.[33] For example, a social mission, such as helping the community, often conflicts with business goals of making money. Differences in goal orientation can trigger manipulation, avoidance, or defiance on the part of one side versus the other unless managers can balance the conflicting demands. When the goals and values of the two sides are mutually exclusive, managers must negotiate and come to some agreement on which direction the company will take. Chapter 7 will discuss organizing for social impact in detail.

2.2d The Importance of Goals

Both official goals and operating goals are important for the organization, but they serve very different purposes. Official goals and mission statements describe a value system for the organization and set an overall purpose and vision; operating goals represent the primary tasks of the organization. Official goals legitimize the organization; operating goals are more explicit and well defined.

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Mission, Official Goals
• Communicate purpose and values
• Bestow legitimacy
Operating Goals
• Provide employee direction and motivation
• Offer decision guidelines
• Define standards of performance

EXHIBIT 2.5
Goal Types and Purposes

Operating goals serve several specific purposes, as outlined in Exhibit 2.5. For one thing, goals provide employees with a sense of direction so that they know what they are working toward. This can help to motivate employees toward specific targets and important outcomes. Numerous studies have shown that specific high goals can significantly increase employee performance.[34] A recent study verified that departments perform significantly better when employees are committed to the goals.[35] People like having a focus for their activities and efforts. Jennifer Dulski, currently head of Groups and Community at Facebook, talks about how she motivated people at a previous organization. "One quarter we had three big goals. I said, 'If we hit all three, it's the trifecta and we're going to all go to the horse races.' And I gave everybody $50 to bet with at the races. I learned as a teacher that everybody has a little kid inside them, and people really love these fun, silly things. They may not admit they love them, but they do."[36] A recent scandal at Wells Fargo provides a negative example of just how powerful goals can be as a motivational tool.

iStock.com/Roman Tiraspolsky

IN PRACTICE
Wells Fargo

Wells Fargo has been battling a series of scandals since it was discovered that employees were opening fake bank accounts and forcing customers into unnecessary products. Even after managers began firing known offenders, the actions continued. Why would they do such a thing? Former employees say the answer is simple: people were breaking the rules and engaging in unethical practices in order to meet high sales goals set by top management. "They warned us about this

(*continued*)

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type of behavior [in ethics workshops] and said, 'You must report it,' but the reality was that people had to meet their goals," said Khalid Taha, a former Wells Fargo personal banker.

Another former employee says his branch managers were continually asking people how many banking solutions (such as checking and savings accounts, credit cards, home equity loans, personal loans, and so forth) they had sold that day. "They wanted three to four a day. In my mind, that was crazy—that's not how people's financial lives work," said Sharif Kellogg. District managers gathered and discussed daily sales for each branch and each individual sales employee four times a day. The aggressive goals pushed some employees to bend the rules by asking friends or local business owners to open additional accounts and promising to close them later. Others opened fake accounts. Eventually, the U.S. Consumer Financial Protection Bureau revealed that more than 5,000 lower-level employees had engaged in the illegal activity. At the time, top executives said the sham accounts were the result of poor decisions by unethical employees, but Kellogg speaks for other employees when he says, "It seems that [managers would] have to be wilfully ignorant to believe that these goals are achievable through any other means."[37]

As shown by this example, another important purpose of goals is to act as guidelines for employee behavior and decision making. Managers can establish appropriate goals that act as a set of constraints on individual behavior and actions so that employees behave within boundaries that are acceptable to the organization and the larger society.[38]

As shown in Exhibit 2.5, goals also help to define the appropriate decisions concerning organization structure, innovation, employee welfare, or growth. Finally, goals provide a standard for assessment. The level of organizational performance, whether in terms of profits, units produced, degree of employee satisfaction, level of innovation, or number of customer complaints, needs a basis for evaluation. Operating goals provide this standard for measurement.

REMEMBER THIS

- Organizations exist for a purpose, and top leaders are responsible for deciding the organization's strategic intent, including a specific mission to be accomplished. The mission statement, or official goals, makes explicit the purpose and direction of an organization.
- Two other factors related to strategic intent are competitive advantage and core competence.
- Competitive advantage refers to what sets the organization apart from others and provides it with a distinctive edge.
- A core competence is something the organization does extremely well compared to competitors.
- Operating goals designate specific ends sought through the actual operating procedures of the organization. Operating goals include performance goals, resource goals, market goals, employee development goals, productivity goals, and innovation and change goals.
- Goal conflict is inevitable in organizations and managers sometimes have to negotiate to reach agreement about the important goals to pursue.
- Official and operating goals are a key element in organizations because they meet these needs—establishing legitimacy with external groups, providing employees with a sense of direction and motivation, providing decision guidelines, and setting standards of performance.

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2.3 Two Frameworks for Selecting Strategy and Design

To support and accomplish the organization's strategic intent and keep people focused in the direction determined by organizational mission, vision, and operating goals, managers select specific strategy and design options that can help the organization achieve its purpose and goals within its competitive environment. In this section, we examine a couple of practical approaches to selecting strategy and design. The questionnaire in this chapter's "How Do You Fit the Design?" box will give you some insight into your own strategic management competencies.

A **strategy** is a plan for interacting with the competitive environment to achieve organizational goals. Some managers think of goals and strategies as interchangeable, but for our purposes *goals* define where the organization wants to go and *strategies* define how it will get there. For example, a goal might be to achieve 15 percent annual sales growth; strategies to reach that goal might include aggressive advertising to attract new customers, motivating salespeople to increase the average size of customer purchases, and acquiring other businesses that produce similar products. Strategies can include any number of techniques to achieve the goal. The essence of formulating strategies is choosing whether the organization will perform different activities than its competitors or will execute similar activities more efficiently than its competitors do.[39]

Two models for formulating strategies are the Porter model of competitive strategies and the Miles and Snow strategy typology. Each provides a framework for competitive action. After describing the two models, we discuss how the choice of strategies affects organization design.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

After goals have been defined, select strategies for achieving those goals. Define specific strategies based on Porter's competitive strategies or Miles and Snow's strategy typology.

2.3a Porter's Competitive Strategies

Michael E. Porter studied a number of business organizations and proposed that managers can make the organization more profitable and less vulnerable by adopting either a differentiation strategy or a low-cost leadership strategy.[40] Using a low-cost leadership strategy means managers choose to compete through lower costs, whereas with a differentiation strategy the organization competes through the ability to offer unique or distinctive products and services that can command a premium price. These two basic strategies are illustrated in Exhibit 2.6. Moreover, each strategy can vary in scope from broad to narrow.

Differentiation. With a **differentiation strategy** the organization attempts to distinguish its products or services from others in the industry. Managers may use advertising, distinctive product features, exceptional service, or new technology to achieve a product perceived as unique. This strategy usually targets customers who are not particularly concerned with price, so it can be quite profitable.

A differentiation strategy can reduce rivalry with competitors and fight off the threat of substitute products because customers are loyal to the company's brand. However, managers must remember that successful differentiation strategies require a number of costly activities, such as product research and design and extensive advertising. Companies that pursue a differentiation strategy need strong marketing abilities and creative employees who are given the time and resources to seek innovations. One good illustration of a company that benefits

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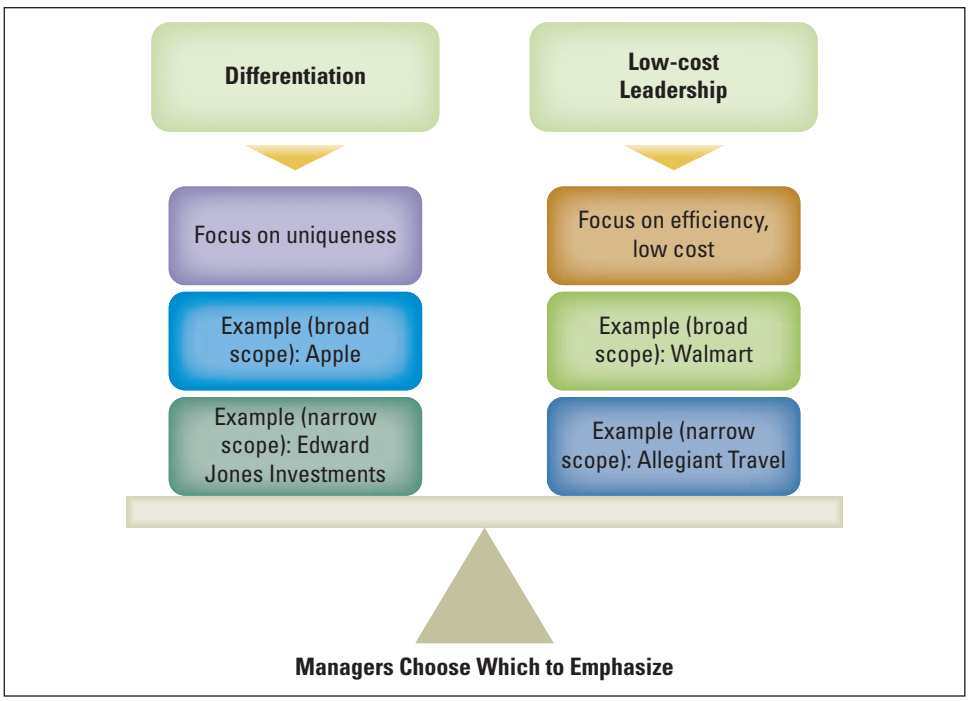
from a differentiation strategy is Apple. Apple has never tried to compete on price and likes being perceived as an "elite" brand. The company has built a loyal customer base by providing innovative, stylish products and creating a prestigious image.

Service firms can use a differentiation strategy as well. Trader Joe's, started in 1967 as a typical convenience store, was quickly modified by founder Joe Coulombe into a novel business serving unique food and drink, and expanded to 17 stores in southern California. Today, there are more than 480 Trader Joe's nationwide, and people are begging for more. But managers are very, very careful about how they expand. TJ's doesn't carry any national brands, but instead offers innovative, high quality, health-conscious food and beverage products at modest prices. About 80 percent of products carry TJ's private label, and the company is secretive about who makes products for them. Many TJ's stores carry only about 2,500 items, compared to a traditional supermarket that has more than 40,000, and the selection is constantly changing. What keeps people coming back is the novelty and sense of adventure—you never know what you're going to find—and the friendly service you might expect at the mom-and-pop shop around the corner. Managers evaluate every decision with an eye to how it fits with the goal of maintaining a neighborhood store feel.[41]

Low-Cost Leadership. The **low-cost leadership strategy** tries to increase market share by keeping costs low compared to competitors. With a low-cost leadership strategy, the organization aggressively seeks efficient facilities, pursues cost reductions, and uses tight controls to produce products or services more efficiently than its competitors. Low cost doesn't necessarily mean low price, but in many cases cost

EXHIBIT 2.6
Porter's Competitive Strategies



Source: Based on Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (New York: The Free Press, 1988).

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HOW DO YOU FIT THE DESIGN?

YOUR STRATEGY/PERFORMANCE STRENGTH

As a potential manager, what are your strengths concerning strategy formulation and implementation? To find out, think about *how you handle challenges and issues* in your schoolwork or job. Then circle *a* or *b* for each of the following items depending on which is more descriptive of your behavior. There are no right or wrong answers. Respond to each item as it best describes how you respond to work situations.

1. When keeping records, I tend to
   - **a.** be very careful about documentation.
   - **b.** be more haphazard about documentation.
2. If I run a group or a project, I
   - **a.** have the general idea and let others figure out how to do the tasks.
   - **b.** try to figure out specific goals, time lines, and expected outcomes.
3. My thinking style could be more accurately described as
   - **a.** linear thinker, going from A to B to C.
   - **b.** thinking like a grasshopper, hopping from one idea to another.
4. In my office or home things are
   - **a.** here and there in various piles.
   - **b.** laid out neatly or at least in reasonable order.
5. I take pride in developing
   - **a.** ways to overcome a barrier to a solution.
   - **b.** new hypotheses about the underlying cause of a problem.
6. I can best help strategy by making sure there is
   - **a.** openness to a wide range of assumptions and ideas.
   - **b.** thoroughness when implementing new ideas.
7. One of my strengths is
   - **a.** commitment to making things work.
   - **b.** commitment to a dream for the future.
8. I am most effective when I emphasize
   - **a.** inventing original solutions.
   - **b.** making practical improvements.

Scoring: For *Strategic Formulator* strength, score one point for each "*a*" answer circled for questions 2, 4, 6, and 8, and for each "*b*" answer circled for questions 1, 3, 5, and 7. For *Strategic Implementer* strength, score one point for each "*b*" answer circled for questions 2, 4, 6, and 8, and for each "*a*" answer circled for questions 1, 3, 5, and 7. Which of your two scores is higher and by how much? The higher score indicates your *Strategy Strength*.

Interpretation: Formulator and Implementer are two important ways managers bring value to strategic management and effectiveness. Managers with implementer strengths tend to work on operating goals and performance to make things more efficient and reliable. Managers with the formulator strength push toward out-of-the-box strategies and like to think about mission, vision, and dramatic breakthroughs. Both styles are essential to strategic management and organizational effectiveness. Strategic formulators often use their skills to create whole new strategies and approaches, and strategic implementers often work with strategic improvements, implementation, and measurement.

If the difference between your two scores is 2 or less, you have a balanced formulator/implementer style and work well in both arenas. If the difference is 4–5, you have a moderately strong style and probably work best in the area of your strength. And if the difference is 7–8, you have a distinctive strength and almost certainly would want to contribute in the area of your strength rather than in the opposite domain.

Source: Adapted from Dorothy Marcic and Joe Seltzer, *Organizational Behavior: Experiences and Cases* (South-Western, 1998), 284–287, and William Miller, *Innovation Styles* (Global Creativity Corporation, 1997).

leaders provide goods and services to customers at cheaper prices. For example, Michael O'Leary, CEO of Irish airline Ryanair said of the company's strategy: "It's the oldest, simplest formula: Pile 'em high and sell 'em cheap. . . . Nobody will beat us on price. EVER." Ryanair can offer low fares because it keeps costs at rock bottom, lower than any other airline in Europe. The company's watchword is cheap tickets, not customer care or unique services.[42]

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The low-cost leadership strategy is concerned primarily with stability rather than taking risks or seeking new opportunities for innovation and growth. A low-cost leadership position means a company can achieve higher profits than competitors because of its efficiency and lower operating costs. Cost leaders such as Ryanair can undercut competitors' prices and still earn a reasonable profit. In addition, if substitute products or potential new competitors enter the picture, the low-cost producer is in a better position to prevent loss of market share.

Porter found that companies that did not consciously adopt a low-cost or differentiation strategy achieved below-average profits compared to those that used one of the strategies. Many Internet companies have failed because managers did not develop competitive strategies that would distinguish them in the marketplace.[43] On the other hand, Google became highly successful with a coherent differentiation strategy that distinguished it from other search engines.

ASSESS YOUR ANSWER

2 The best business strategy is to make products and services as distinctive as possible to gain an edge in the marketplace.

ANSWER: *Disagree.* Differentiation, making the company's products or services distinctive from others in the market, is one effective strategic approach. A low-cost leadership approach can be equally or even more effective depending on the organization's strengths and the nature of competition in the industry.

Competitive Scope Can Be Broad or Narrow. With either strategy, the scope of competitive action can be either broad or narrow. That is, an organization can choose to compete in many market and customer segments or to focus on a specific market or buyer group. For example, Walmart uses a low-cost leadership strategy and competes in a broad market, selling to many market segments. A good example of a narrowly focused low-cost leadership strategy is Allegiant Air.

IN PRACTICE

Allegiant Air

"We want to be considered the hometown airline of all the little cities around the country," Andrew Levy, former president of Allegiant Air, once said. Allegiant flies just 85 jets and specializes in flying people from small, underserved cities such as Minot, North Dakota, and Plattsburg, New York, to warm-weather tourist destinations such as Orlando, Las Vegas, and Honolulu. Although the company has expanded to serve larger cities and other destinations—even announcing flights to Anchorage, Alaska beginning in May 2019—serving small regional airports remains its focus.

Allegiant's focused low-cost leadership strategy has made it one of the most profitable airlines in the industry. Managers believe in "attacking niche opportunities." For example, Allegiant moved in when other airlines left the shrinking cities of the Rust Belt and lures Canadian fliers just across the border to fly out of small U.S. airports. The airline has now set its sights on Mexico, hoping to fly middle-class Mexicans from cities such as Zacatecas or Culiacán to tourist destinations such as Las Vegas in the United States.

Allegiant goes to extremes to meet its goals of low cost. It depends largely on word-of-mouth advertising rather than paying travel agents. It offers a no-frills base fare and charges for nearly everything else, from carry-on luggage to water. Managers also say they "only fly when we can make money." "On Tuesdays, we look like a bankrupt airline," the former CEO said, but "who wants to start their vacation on a Tuesday?"[44]

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An example of a narrowly focused differentiation strategy is Edward Jones Investments, a St. Louis-based brokerage house. The company concentrates on building its business in rural and small-town America and providing clients with conservative, long-term investment advice. Management scholar and consultant Peter Drucker once said the distinctive safety-first orientation means Edward Jones delivers a product "that no Wall Street house has ever sold before: peace of mind."[45]

2.3b Miles and Snow's Strategy Typology

Another strategy typology was developed from the study of business strategies by Raymond Miles and Charles Snow.[46] The Miles and Snow typology is based on the idea that managers seek to formulate strategies that will be congruent with the external environment. Organizations strive for a fit among internal organization characteristics, strategy, and the external environment. The four strategies that can be developed are the prospector, the defender, the analyzer, and the reactor.

Prospector. The **prospector** strategy is to innovate, take risks, seek out new opportunities, and grow. This strategy is suited to a dynamic, growing environment, where creativity to separate the organization from competitors is more important than efficiency. Nike, which innovates in both products and internal processes, exemplifies the prospector strategy. For example, the company introduced a new line of shoes based on designs that can be produced using recycled materials and limited amounts of toxic chemical-based glues.[47] Companies such as Uber and Facebook also use a prospector strategy.

Another company that uses a prospector strategy is the Cadillac division of General Motors. Since its beginning over a century ago, Cadillac has been a leader in technological and design breakthroughs. In the early 1900s, it put a fixed roof on the Model H and became the first company to build a car with a totally enclosed cabin. The company also invented the electric starter, introduced the industry's first thermostatically regulated heating, ventilation and air conditioning system, invented magnetic ride control, and was the first to integrate a global positioning satellite (GPS) system. Although Cadillac is not the strong leader it once was, managers continue to encourage people to pursue any technology or refinement that can enhance the brand's status. "Innovation isn't just what we do; it's coded in our DNA," states the Cadillac website.[48]

Defender. The **defender** strategy is almost the opposite of the prospector. Rather than taking risks and seeking out new opportunities, the defender strategy is concerned with stability or even retrenchment. This strategy seeks to hold on to current customers, but it neither innovates nor seeks to grow. The defender is concerned primarily with internal efficiency and control to produce reliable, high-quality products for steady customers. This strategy can be successful when the organization exists in a declining industry or a stable environment. Paramount Pictures has been using a defender strategy for several years.[49] Paramount turns out a steady stream of reliable hits but few blockbusters. Managers shun risk and sometimes turn down potentially high-profile films to keep a lid on costs. This has enabled the company to remain highly profitable while other studios have low returns or actually lose money.

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Analyzer. The **analyzer** tries to maintain a stable business while innovating on the periphery. It seems to lie midway between the prospector and the defender. Some products will be targeted at stable environments in which an efficiency strategy designed to keep current customers is used. Others will be targeted at new, more dynamic environments, where growth is possible. The analyzer attempts to balance efficient production for current product or service lines with the creative development of new product lines. Amazon.com provides an example. The company's current strategy is to defend its core business of selling books and other physical goods over the Internet, but also to build businesses in multiple other areas, including a digital book service, new book content publishing, music and video streaming, games, and consumer electronics. Amazon is also exploring a limited brick-and-mortar presence with physical stores as part of its analyzer strategy.[50]

Reactor. The **reactor** strategy is not really a strategy at all. Rather, reactors respond to environmental threats and opportunities in an ad hoc fashion. With a reactor strategy, top management has not defined a long-range plan or given the organization an explicit mission or goal, so the organization takes whatever actions seem to meet immediate needs. Although the reactor strategy can sometimes be successful, it can also lead to failed companies. Some large, once highly successful companies, such as Blockbuster, have all but disappeared because managers failed to adopt a strategy consistent with consumer trends. In March 2019, there was only one video rental store left for the once ubiquitous video and game rental chain. What remains of the Blockbuster organization is now owned by Dish Network.

The Miles and Snow typology has been widely used, and researchers have tested its validity in a variety of organizations, including hospitals, colleges, banking institutions, industrial products companies, and life insurance firms. In general, researchers have found strong support for the effectiveness of this typology for organization managers in real-world situations.[51]

The ability of managers to devise and maintain a clear competitive strategy is considered one of the defining factors in an organization's success, but many managers struggle with this crucial responsibility.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Design the organization to support the firm's competitive strategy. With a low-cost leadership or defender strategy, select design characteristics associated with an efficiency orientation. For a differentiation or prospector strategy, on the other hand, choose characteristics that encourage learning, innovation, and adaptation. Use a balanced mixture of characteristics for an analyzer strategy.

2.3c How Strategies Affect Organization Design

Choice of strategy affects internal organization characteristics. Organization design characteristics need to support the firm's competitive approach. For example, a company wanting to grow and invent new products looks and "feels" different from a company that is focused on maintaining market share for long-established products in a stable industry. Exhibit 2.7 summarizes organization design characteristics associated with the Porter and Miles and Snow strategies.

With a low-cost leadership strategy, managers take a primarily mechanistic, efficiency approach to organization design, whereas a differentiation strategy calls for a more organic, learning approach. Recall from Chapter 1 that mechanistic organizations designed for efficiency have different characteristics from organic organizations designed for learning. A low-cost leadership strategy (efficiency) is associated with strong, centralized authority and tight control, standard operating procedures, and emphasis on efficient procurement and distribution systems. Employees generally perform routine tasks under close supervision and control and are not empowered to make decisions or take action on their own. A differentiation strategy, on the other hand, requires that employees be constantly experimenting and learning. Structure is fluid and flexible, with strong horizontal coordination.

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EXHIBIT 2.7
Organization Design Outcomes of Strategy

Porter's Competitive Strategies	Miles and Snow's Strategy Typology
Strategy: Differentiation **Organization Design:** • Learning orientation; acts in a flexible, loosely knit way, with strong horizontal coordination • Strong capability in research? • Values and builds in mechanisms for customer intimacy • Rewards employee creativity, risk-taking, and innovation **Strategy:** Low-Cost Leadership **Organization Design:** • Efficiency orientation; strong central authority; tight cost control, with frequent, detailed control reports • Standard operating procedures • Highly efficient procurement and distribution systems • Close supervision; routine tasks; limited employee empowerment	**Strategy:** Prospector **Organization Design:** • Learning orientation; flexible, fluid, decentralized structure • Strong capability in research **Strategy:** Defender **Organization Design:** • Efficiency orientation; centralized authority; tight cost control • Emphasis on production efficiency; low overhead • Close supervision; little employee empowerment **Strategy:** Analyzer **Organization Design:** • Balances efficiency and learning; tight cost control with flexibility and adaptability • Efficient production for stable product lines; emphasis on creativity, research, risk-taking for innovation **Strategy:** Reactor **Organization Design:** • No clear organizational approach; design characteristics may shift abruptly, depending on current needs

Source: Based on Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (New York: The Free Press, 1980); Michael Treacy and Fred Wiersema, "How Market Leaders Keep Their Edge," *Fortune*, (February 6, 1995), 88–98; Michael Hitt, R. Duane Ireland, and Robert E. Hoskisson, *Strategic Management* (St. Paul, MN: West, 1995), 100–113; and Raymond E. Miles, Charles C. Snow, Alan D. Meyer, and Henry J. Coleman, Jr., "Organizational Strategy, Structure, and Process," *Academy of Management Review* 3 (1978), 546–562.

Empowered employees work directly with customers and are rewarded for creativity and risk-taking. The organization values research, creativity, and innovativeness over efficiency and standard procedures.

The prospector strategy requires characteristics similar to a differentiation strategy, and the defender strategy takes an efficiency approach similar to low-cost leadership. Because the analyzer strategy attempts to balance efficiency for stable product lines with flexibility and learning for new products, it is associated with a mix of characteristics, as listed in Exhibit 2.7. With a reactor strategy, managers have left the organization with no direction and no clear approach to design.

2.3d Other Contingency Factors Affecting Organization Design

Strategy is one important factor that affects organization design. Ultimately, however, organization design is a result of numerous contingencies, which will be discussed

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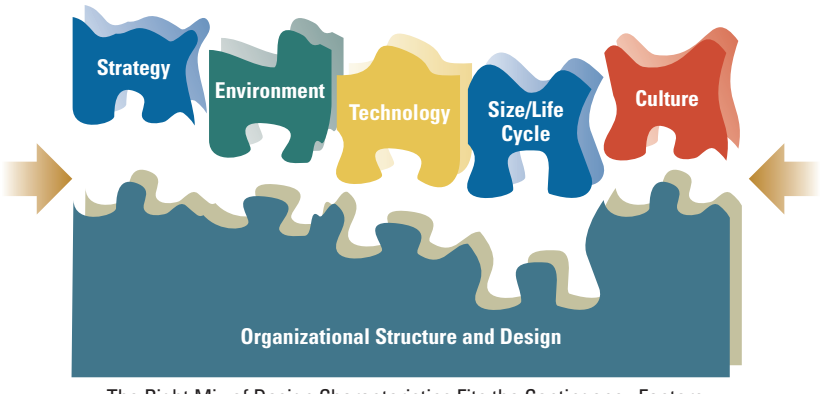
throughout this book. The emphasis given to efficiency and control (mechanistic) versus learning and flexibility (organic) is determined by the contingencies of strategy, environment, size and life cycle, technology, and organizational culture. The organization is designed to "fit" the contingency factors, as illustrated in Exhibit 2.8.

In a stable environment, for example, the organization can have a traditional mechanistic structure that emphasizes vertical control, efficiency, specialization, standard procedures, and centralized decision making. However, a rapidly changing environment may call for a more flexible, organic structure, with strong horizontal coordination and collaboration through teams or other mechanisms. Environment will be discussed in detail in Chapter 4 and Chapter 5. In terms of size and life cycle, young, small organizations are generally informal and have little division of labor, few rules and regulations, and ad hoc budgeting and performance systems. Large organizations such as Coca-Cola, Samsung, or General Electric, on the other hand, have an extensive division of labor, numerous rules and regulations, and standard procedures and systems for budgeting, control, rewards, and innovation. Size and stages of the life cycle will be discussed in Chapter 10.

Design must also fit the workflow technology of the organization. For example, with mass production technology, such as a traditional automobile assembly line, the organization functions best by emphasizing efficiency, formalization, specialization, centralized decision making, and tight control. An e-business, on the other hand, would need to be more informal and flexible. Technology's impact on design will be discussed in detail in Chapter 8 and Chapter 9. A final contingency that affects organization design is corporate culture. An organizational culture that values teamwork, collaboration, creativity, and open communication, for example, would not function well with a tight, vertical structure and strict rules and regulations. The role of culture is discussed in Chapter 11.

One responsibility of managers is to design organizations that fit the contingency factors of strategy, environment, size and life cycle, technology, and culture. Finding the right fit leads to organizational effectiveness, whereas a poor fit can lead to decline or even the demise of the organization.

EXHIBIT 2.8
Contingency Factors Affecting Organization Design



The Right Mix of Design Characteristics Fits the Contingency Factors

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REMEMBER THIS

- Strategies may include any number of techniques to achieve the stated goals. Two models for formulating strategies are Porter's competitive strategies and Miles and Snow's strategy typology.
- Using Porter's low-cost leadership strategy means managers choose to compete through efficiency and lower costs, whereas with a differentiation strategy the organization competes through the ability to offer unique or distinctive products and services that can command a premium price.
- Miles and Snow's typology includes prospector strategy, which is concerned with innovation and growth; defender strategy, which is concerned with stability; analyzer strategy, which balances a stable business with innovation on the periphery; and reactor strategy, in which managers have failed to define a long-range plan and the organization responds to environmental changes in an ad hoc fashion.
- Organization design should fit the firm's competitive approach and the various contingency factors to contribute to organizational effectiveness.

2.4 Assessing Organizational Effectiveness

Understanding organizational goals and strategies, as well as the concept of fitting design to various contingencies, is a first step toward understanding organizational effectiveness. Organizational goals represent the reason for an organization's existence and the outcomes it seeks to achieve. The rest of this chapter explores the topic of effectiveness and how effectiveness is measured in organizations.

2.4a Definition of Organizational Effectiveness

Recall from Chapter 1 that organizational effectiveness is the degree to which an organization realizes its goals. *Effectiveness* is a broad concept. It implicitly takes into consideration a range of variables at both the organizational and departmental levels. Effectiveness evaluates the extent to which multiple goals—whether official or operating—are attained. *Efficiency* is a more limited concept that pertains to the internal workings of the organization. Organizational efficiency is the amount of resources used to produce a unit of output.[52] It can be measured as the ratio of inputs to outputs. If one organization can achieve a given production level with fewer resources than another organization, it would be described as more efficient.[53]

Sometimes efficiency leads to effectiveness, but in other organizations efficiency and effectiveness are not related. An organization may be highly efficient but fail to achieve its goals because it makes a product for which there is no demand. Likewise, an organization may achieve its profit goals but be inefficient. Efforts to increase efficiency, particularly through severe cost cutting, can also sometimes make the organization less effective. Recall the previous example of Kraft Heinz, where a new focus on goals of cost-cutting and efficiency have hurt innovation and the company's ability to adapt. As another example, a regional fast food chain wanting to

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increase efficiency decided to reduce food waste by not cooking any food until it was ordered. The move cut the chain's costs, but it also led to delayed service, irritated customers, and lower sales.[54]

Overall effectiveness is difficult to measure in organizations. Organizations are large, diverse, and fragmented; they perform many activities simultaneously, pursue multiple goals, and generate many outcomes, some intended and some unintended.[55] Managers determine what indicators to measure in order to gauge the effectiveness of their organizations.

2.4b Who Decides?

Key people in charge of the organization, such as top executives or board members, have to make a conscious decision about how they will determine the organization's effectiveness. Just as people determine goals, they also determine when the organization is successful. Organizational effectiveness is a **social construct**, meaning that it is created and defined by an individual or group rather than existing independently in the external world.[56]

An employee might consider the organization is effective if it issues accurate paychecks on time and provides promised benefits. A customer might consider it effective if it provides a good product at a low price. A CEO might consider the organization effective if it is profitable. Effectiveness is always multidimensional, and thus assessments of effectiveness are typically multidimensional as well. Managers in businesses typically use profits and stock performance as indicators of effectiveness, but they also give credence to other measures, such as employee satisfaction, customer loyalty, corporate citizenship, innovativeness, or industry reputation.[57]

As open systems, organizations bring in resources from the environment, and those resources are transformed into outputs delivered back into the environment, as shown in Exhibit 2.9. In addition, recall from Chapter 1 that organizations interact with a number of stakeholder groups inside and outside the organization. Four key approaches to measuring effectiveness look at different parts of the organization and measure indicators connected with outputs, inputs, internal activities, or key stakeholders, also called strategic constituents.[58] These four possible approaches to measuring effectiveness are:

- The Goal Approach
- The Resource-Based Approach
- The Internal Process Approach
- The Strategic Constituents Approach

Managers often use indicators from more than one of the four approaches (goal, resource, internal process, strategic constituents) when measuring effectiveness. Exhibit 2.10 lists a sample of 15 indicators that managers of large, multinational organizations reported using to assess effectiveness. As you read the descriptions of the four approaches to measuring effectiveness in the following sections, try to decide which approach each of these 15 indicators falls under.[59]

As the items in Exhibit 2.10 reveal, indicators of effectiveness are both quantitative and qualitative, tangible and intangible. An indicator such as achieving sales targets or percentage of market share is easy to measure, but indicators such as employee engagement, quality, or customer satisfaction are less clear-cut and often must be measured qualitatively.[60] Relying solely on quantitative measurements can give managers a limited or distorted view of effectiveness. Albert Einstein is

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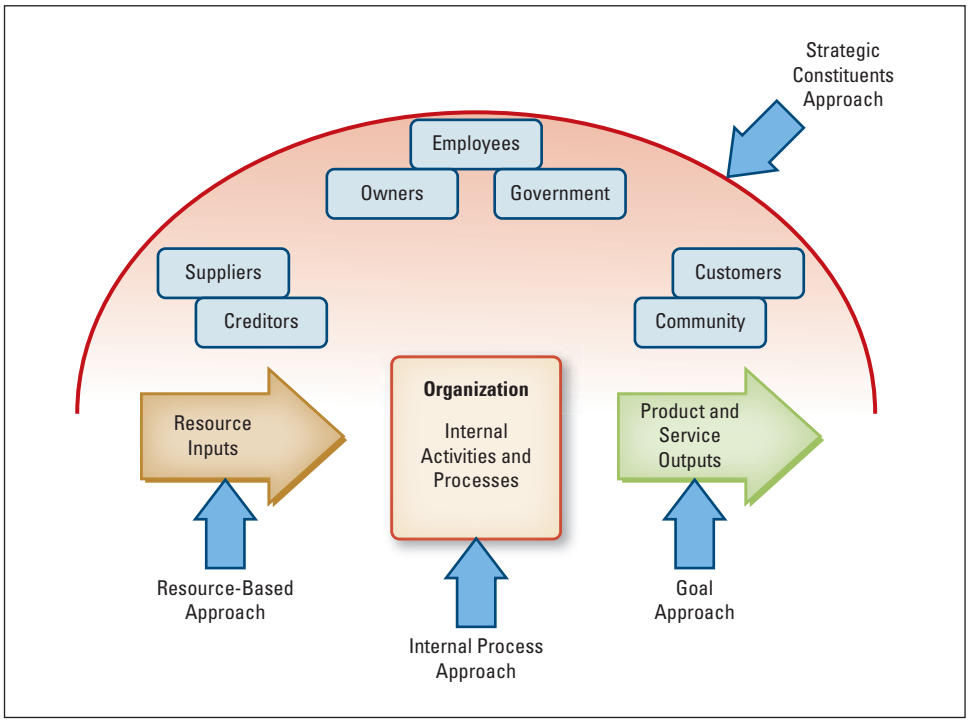

EXHIBIT 2.9
Four Approaches to Measuring Organizational Effectiveness

reported to have kept a sign in his office that read, "Not everything that counts can be counted, and not everything that can be counted counts."[61]

2.4c Goal Approach

The **goal approach** to effectiveness consists of identifying an organization's goals and assessing how well the organization has attained those goals.[62] This is a logical approach because organizations do try to attain certain levels of output, profit, or client satisfaction. For example, one major goal for Uber was to regain its license to operate in London, one of the company's most profitable markets outside the United States. Under the direction of a new CEO, Dara Khosrowshahi, Uber is toning down its "grow-at-any-cost" culture, and the company's goals now include proving to government officials that Uber can comply with local rules and regulations. Uber won its appeal to have the London license renewed after managers agreed to stricter government oversight, including new systems for reporting problems to regulators.[63] The goal approach measures progress toward the attainment of those goals.

Indicators. The important goals to consider are operating goals, because official goals (mission) tend to be abstract and difficult to measure. Operating goals reflect activities the organization is actually performing.[64]

Indicators tracked with the goal approach include:

- Profitability—the positive gain from business operations or investments after expenses are subtracted
- Market share—the proportion of the market the firm is able to capture relative to competitors

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EXHIBIT 2.10
Some Indicators of Organizational Effectiveness Reported by Multinational Organizations

1. Meeting deadlines; on-time delivery
2. Timely material and equipment acquisition
3. Quality of product or service
4. Customer satisfaction/complaints
5. Market share compared to competitors
6. Employee training and development (number of hours)
7. Staying within budget
8. Shareholder satisfaction
9. Reduction in costs
10. Supply chain delays or improvements
11. Productivity; dollars spent for each unit of output
12. Employee engagement
13. Achieving sales targets
14. Product development cycle time (reduction in cycle time)
15. Number of hours/days and so on to complete tasks

Source: Based on "Table 1; Initial Items Derived from Interviews," in Cristina B. Gibson, Mary E. Zellmer-Bruhn, and Donald P. Schwab, "Team Effectiveness in Multinational Organizations: Evaluation Across Contexts," *Group & Organizational Management 28*, no. 4 (December 2003), 444–474.

- Growth—the ability of the organization to increase its sales, profits, or client base over time
- Social responsibility—how well the organization serves the interests of society as well as itself
- Product quality—the ability of the organization to achieve high quality in its products or services

Usefulness. The goal approach is used in business organizations because output goals can be readily measured. Some nonprofit organizations that aim to solve social problems also find the goal approach useful. For example, Every Child Succeeds is a public-private partnership funded primarily by United Way that aims to reduce infant mortality and improve maternal health in the area surrounding Cincinnati, Ohio. In the seven Ohio and Kentucky counties around the city, 8.3 out of every 1,000 newborns die before they reach their first birthday, on par with countries such as Lithuania and Brunei. Yet among the mothers enrolled in Every Child Succeeds, that statistic is only 2.8 percent, lower than in virtually every industrialized country. Using a rigorous model of performance measurement based on some of the management practices at P&G, social workers and nurses visit at-risk mothers in their homes and help them stop smoking, control their diabetes or high blood pressure, and improve their health in other ways. Unlike many social improvement programs, Every Child Succeeds sets and measures a few narrow and specific goals organized under seven focus areas.[65]

In businesses as well as in nonprofit organizations such as Every Child Succeeds, identifying operating goals and measuring effectiveness are not always easy. Two problems that must be resolved are the issues of multiple goals and subjective indicators of goal attainment. Since organizations have multiple and sometimes conflicting goals, effectiveness cannot be assessed by a single indicator. High achievement

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on one goal might mean low achievement on another. Moreover, there are department goals as well as overall organizational goals. The full assessment of effectiveness should take into consideration several goals simultaneously.

The other issue to resolve with the goal approach is how to identify operating goals for an organization and how to measure goal attainment. For business organizations, there are often objective indicators for certain goals, such as profit or growth. Every Child Succeeds can also use objective indicators for some goals, such as tracking how many infants are immunized or how many clients stop smoking during pregnancy. However, subjective assessment is needed for other goals, such as employee welfare, social responsibility, or client satisfaction. Top managers and other key people on the management team have to clearly identify which goals the organization will measure. Subjective perceptions of goal attainment must be used when quantitative indicators are not available. Managers rely on information from customers, competitors, suppliers, and employees, as well as their own intuition, when considering these goals.

2.4d Resource-Based Approach

The **resource-based approach** looks at the input side of the transformation process shown in Exhibit 2.9. It assumes organizations must be successful in obtaining and managing valued resources in order to be effective because strategically valuable resources give an organization a competitive edge.[66] From a resource-based perspective, organizational effectiveness is defined as the ability of the organization, in either absolute or relative terms, to obtain scarce and valued resources and successfully integrate and manage them.[67]

Indicators. Obtaining and successfully managing resources is the criterion by which organizational effectiveness is assessed. In a broad sense, resource indicators of effectiveness encompass the following dimensions:[68]

- Bargaining position—the ability of the organization to obtain from its environment scarce and valued resources, including tangible resources such as a prime location, financing, raw materials, and quality employees, and intangible assets such as a strong brand or superior knowledge
- The abilities of the organization's decision makers to perceive and correctly interpret the real properties of the external environment and supply forces
- The abilities of managers to use tangible (e.g., supplies, people) and intangible (e.g., knowledge, corporate culture) resources and capabilities in day-to-day organizational activities to achieve superior performance
- The ability of the organization to respond to changes in resource sectors of the environment

Usefulness. The resource-based approach is valuable when other indicators of performance are difficult to obtain. In many nonprofit and social welfare organizations, for example, it is hard to measure output goals or internal efficiency. The Shriners Hospitals for Children (SHC) system provides an example. The 22 Shriners Hospitals provide free treatment to thousands of children with orthopaedic conditions, burns, spinal cord injuries, and cleft lip and palette conditions. For most of its history, the SHC was highly successful in obtaining donations, the main source of funding for the hospitals' operations. However, when the federal government launched a no-cost health insurance program for children of low-income families,

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BRIEFCASE

As an organization manager, keep these guidelines in mind:

Use the goal approach, internal process approach, and resource-based approach to obtain specific interpretations of organizational effectiveness in the areas of outputs, internal processes, and inputs. Assess the satisfaction of strategic constituents or use the competing values model to obtain a broader picture of effectiveness.

Shriners began losing patients to traditional healthcare providers. With a decline in patient registrations, donations began to decline as well. Managers had to search for new ways to respond to the increased competition and obtain needed resources.[69] Some for-profit organizations also use a resource-based approach because resources are critical to competitive success. For example, the British retail firm Marks & Spencer evaluates its effectiveness partly by looking at the company's ability to obtain, manage, and maintain valued resources such as prime locations for stores, a strong brand, quality employees, and effective supplier relationships.[70]

Although the resource-based approach is valuable when other measures of effectiveness are not available, it does have shortcomings. For one thing, the approach only vaguely considers the organization's link to the needs of customers. A superior ability to acquire and use resources is important only if resources and capabilities are used to achieve something that meets a need in the environment. Critics have challenged that the approach assumes stability in the marketplace and fails to adequately consider the changing value of various resources as the competitive environment and customer needs change.[71]

2.4e Internal Process Approach

In the **internal process approach**, effectiveness is measured as internal organizational health and efficiency. An effective organization has a smooth, well-oiled internal process. Employees are happy and satisfied. Department activities mesh with one another to ensure high productivity. This approach does not consider the external environment. The important element in effectiveness is what the organization does with the resources it has, as reflected in internal health and efficiency.

Indicators. One indicator of internal process effectiveness is economic efficiency. However, the best-known proponents of an internal process model are from the human relations approach to organizations. Such writers as Chris Argyris, Warren G. Bennis, Rensis Likert, and Richard Beckhard have all worked extensively with human resources in organizations and emphasize the connection between human resources and effectiveness.[72] Results from a study of nearly 200 secondary schools showed that both human resources and employee-oriented processes were important in explaining and promoting effectiveness in those school organizations.[73]

Internal process indicators include:[74]

- A strong, adaptive corporate culture and positive work climate
- Confidence and trust between employees and management
- Operational efficiency, such as using minimal resources to achieve outcomes
- Undistorted horizontal and vertical communication
- Growth and development of employees
- Coordination among the organization's parts, with conflicts resolved in the interest of the larger organization

Usefulness. The internal process approach is important because the efficient use of resources and harmonious internal functioning are good ways to assess organizational effectiveness. At Campbell Soup's Maxton, North Carolina-based factory, hundreds of small changes and improvements, many suggested by employees, increased operating efficiency to 85 percent of what managers believe is the maximum possible. UPS put devices on its delivery trucks to track how many left-turns against traffic its drivers have to make. By helping drivers optimize their routes with fewer left turns, the system will save UPS 1.4 million gallons of fuel per year.[75]

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Today, most managers believe that committed, actively involved employees and a positive corporate culture are also important internal measures of effectiveness. The internal process approach also has shortcomings. Total output and the organization's relationship with the external environment are not evaluated. Another problem is that evaluations of internal health and functioning are often subjective because many aspects of inputs and internal processes are not quantifiable. Managers should be aware that this approach alone represents a limited view of organizational effectiveness. Following the merger of Burlington Northern Railroad and the Atchison, Topeka, and Santa Fe Railway, managers at BNSF Railway committed to creating an environment that provided overall organizational effectiveness, and they combine an internal process approach to measuring effectiveness with other approaches.

As this example illustrates, many organizations use more than one approach to measuring effectiveness because organizations pursue many different types of activities and serve many different interests.

IN PRACTICE

BNSF Railway

When faced with merging two operating systems, management systems, and cultures into one cohesive organization, managers at BNSF knew they could let the culture develop naturally over time or be active participants in creating the culture they wanted. They chose to take a deliberate role in building a positive internal environment.

Indicators of internal effectiveness at BNSF are that people take pride in working at the railway and have opportunities for personal growth and development. Shared values include listening to customers and doing what it takes to meet their expectations. In addition, managers focus employees on continuous improvement and provide a safe working environment.

Managers combine measures of internal process effectiveness with measures of how well BNSF meets goals for 100 percent on-time, damage-free customer service, accurate and timely information about their customer shipments, and giving customers the best value for their transportation dollar. Other goals are for shareholder returns that exceed other railroads and a return on invested capital that is greater than BNSF's cost of capital.

Other stakeholders are considered as well. BNSF considers its ethical and legal commitments to the communities it serves, as well as its sensitivity to the natural environment in evaluating overall effectiveness.[76]

2.4f Strategic Constituents Approach

The strategic constituents approach is related to the stakeholder approach described in Chapter 1. Recall that organizations have a variety of internal and external stakeholders that may have competing claims on what they want from the organization. Several important stakeholder groups are also shown at the top of Exhibit 2.9.

In reality, it is unreasonable to assume that all stakeholders can be equally satisfied. The **strategic constituents approach** measures effectiveness by focusing on the satisfaction of key stakeholders, those who are critical to the organization's ability to survive and thrive. The satisfaction of these strategic constituents can be assessed as an indicator of the organization's performance.[77]

Indicators. The initial work on evaluating effectiveness on the basis of strategic constituents looked at 97 small businesses and seven groups relevant to those organizations. Members of each group were surveyed to determine the perception of effectiveness from each viewpoint.[78] Each constituent group had a different criterion of effectiveness:

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Strategic Constituent Group	Effectiveness Criteria
Owners	Financial return
Employees	Pay, good supervision, worker satisfaction
Customers	Quality of goods and services
Creditors	Creditworthiness
Community	Contribution to community affairs
Suppliers	Satisfactory transactions
Government	Obedience to laws and regulations

If an organization fails to meet the needs of several constituent groups, it is probably not meeting its effectiveness goals. Although these seven groups reflect constituents that nearly every organization has to satisfy to some degree, each organization might have a different set of strategic constituents. For example, independent software developers are key to the success of companies such as Facebook even though they are not necessarily customers, suppliers, or owners.

Usefulness. Research has shown that the assessment of multiple constituents is an accurate reflection of organizational effectiveness, especially with respect to organizational adaptability.[79] Moreover, both profit and nonprofit organizations care about their reputations and attempt to shape perceptions of their performance.[80] The strategic constituents approach takes a broad view of effectiveness and examines factors in the environment as well as within the organization. It looks at several criteria simultaneously—inputs, internal processes, and outputs—and acknowledges that there is no single measure of effectiveness.

The strategic constituents approach is popular because it is based on the understanding that effectiveness is a complex, multidimensional concept and has no single measure.[81] In the following section, we look at another popular approach that takes a multidimensional, integrated approach to measuring effectiveness.

REMEMBER THIS

- Assessing organizational effectiveness reflects the complexity of organizations as a topic of study.
- Effectiveness is a social construct, meaning that it is created and defined by people rather than existing independently in the external world.
- Different groups of people often have different views and criteria for what makes the organization "effective." Managers must decide how they will define and measure the organization's effectiveness.
- No easy, simple, guaranteed measure will provide an unequivocal assessment of effectiveness. Organizations must perform diverse activities well—from obtaining resource inputs to delivering outputs—to be successful.
- Four approaches to measuring effectiveness are the goal approach, resource-based approach, internal process approach, and strategic constituents approach. Effectiveness is multidimensional, so managers typically use indicators from more than one approach and they use qualitative as well as quantitative measures.
- No approach is suitable for every organization, but each approach offers some advantages that the others may lack.

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2.5 An Integrated Effectiveness Model

The **competing values model** tries to balance a concern with various parts of the organization rather than focusing on one part. This approach to effectiveness acknowledges that organizations do many things and have many outcomes.[82] It combines several indicators of effectiveness into a single framework.

The model is based on the assumption that there are disagreements and competing viewpoints about what constitutes effectiveness. Managers sometimes disagree over which are the most important goals to pursue and measure. One tragic example of conflicting viewpoints and competing interests comes from NASA. After seven astronauts died in the explosion of the space shuttle Columbia in February 2003, an investigative committee found deep organizational flaws at NASA, including ineffective mechanisms for incorporating dissenting opinions between scheduling managers and safety managers. External pressures to launch on time overrode safety concerns with the Columbia launch.[83] Similarly, Congressional investigations of the 2010 Deepwater Horizon oil rig explosion and oil spill in the Gulf of Mexico found that BP engineers and managers made a number of decisions that were counter to the advice of key contractors, putting goals of cost control and timeliness ahead of concerns over well safety.[84] BP and NASA represent how complex organizations can be, operating not only with different viewpoints internally but also from contractors, government regulators, Congress, and the expectations of the American public.

The competing values model takes into account these complexities. The model was originally developed by Robert Quinn and John Rohrbaugh to combine the diverse indicators of performance used by managers and researchers.[85] Using a comprehensive list of performance indicators, a panel of experts in organizational effectiveness rated the indicators for similarity. Their analysis found underlying dimensions of effectiveness criteria that represented competing management values in organizations.

Indicators. The first value dimension pertains to organizational **focus**, which is whether dominant values concern issues that are *internal* or *external* to the firm. Internal focus reflects a management concern for the well-being and efficiency of employees, and external focus represents an emphasis on the well-being of the organization itself with respect to the environment. The second value dimension pertains to organization **structure** and whether *stability* or *flexibility* is the dominant structural consideration. Stability reflects a management value for efficiency and top-down control, whereas flexibility represents a value for learning and change.

The value dimensions of structure and focus are illustrated in Exhibit 2.11. The combination of dimensions provides four approaches to organizational effectiveness, which, though seemingly different, are closely related. In real organizations, these competing values can and often do exist together. Each approach reflects a different management emphasis with respect to structure and focus.[86]

A combination of external focus and flexible structure leads to an **open systems emphasis**. Management's primary goals are growth and resource acquisition. The organization accomplishes these goals through the subgoals of flexibility, readiness, and a positive external evaluation. The dominant value is establishing a good relationship with the environment to acquire resources and grow. This emphasis is similar in some ways to the resource-based approach described earlier.

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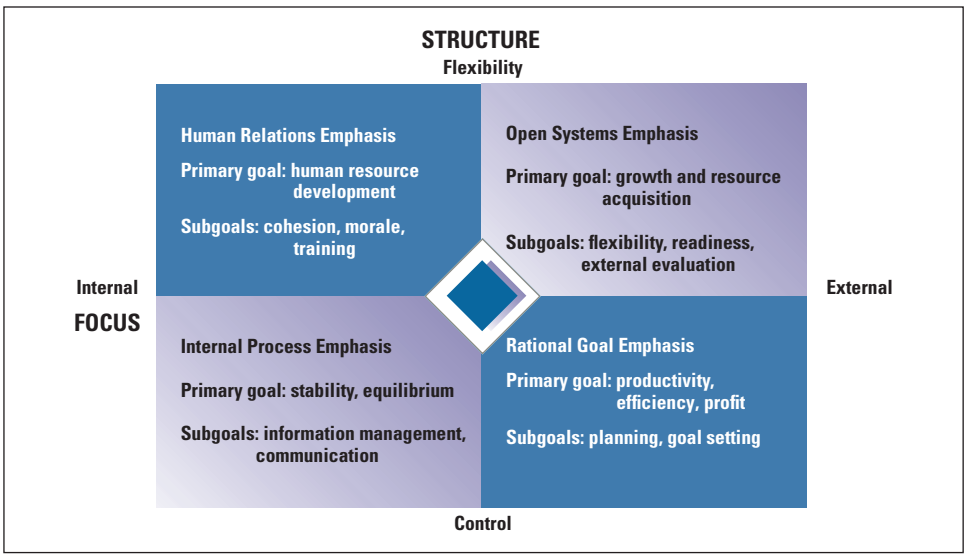
The **rational goal emphasis** represents management values of structural control and external focus. The primary goals are productivity, efficiency, and profit. The organization wants to achieve output goals in a controlled way. Subgoals that facilitate these outcomes are internal planning and goal setting, which are rational management tools. The rational goal emphasis is similar to the goal approach described earlier.

The **internal process emphasis** is in the lower-left section of Exhibit 2.11; it reflects the values of internal focus and structural control. The primary outcome is a stable organizational setting that maintains itself in an orderly way. Organizations that are well established in the environment and simply want to maintain their current position would reflect this emphasis. Subgoals include mechanisms for efficient communication, information management, and decision making. Although this part of the competing values model is similar in some ways to the internal process approach described earlier, it is less concerned with human resources than with other internal processes that lead to efficiency.

The **human relations emphasis** incorporates the values of an internal focus and a flexible structure. Here, management concern is for the development of human resources. Employees are given opportunities for autonomy and development. Management works toward the subgoals of cohesion, morale, and training opportunities. Organizations adopting this emphasis are more concerned with employees than with the environment.

The four cells in Exhibit 2.11 represent opposing organizational values. Managers decide which values will take priority in the organization. For example, managers at Stryker Corporation, which makes surgical equipment and implants used in joint replacements, among other medical devices, emphasize values of openness and flexibility to keep people throughout the company innovating on a day-to-day basis. Yet the organization also has values of control and efficiency. Stryker keeps research and development costs relatively low compared to other device makers.[87] The way two organizations are mapped onto the four approaches is shown in Exhibit 2.12.[88]

EXHIBIT 2.11
Four Approaches to Effectiveness Values



Source: Adapted from Robert E. Quinn and John Rohrbaugh, "A Spatial Model of Effectiveness Criteria: Toward a Competing Values Approach to Organizational Analysis," *Management Science* 29 (1983), 363–377; and Robert E. Quinn and Kim Cameron, "Organizational Life Cycles and Shifting Criteria of Effectiveness: Some Preliminary Evidence," *Management Science* 29 (1983), 33–51.

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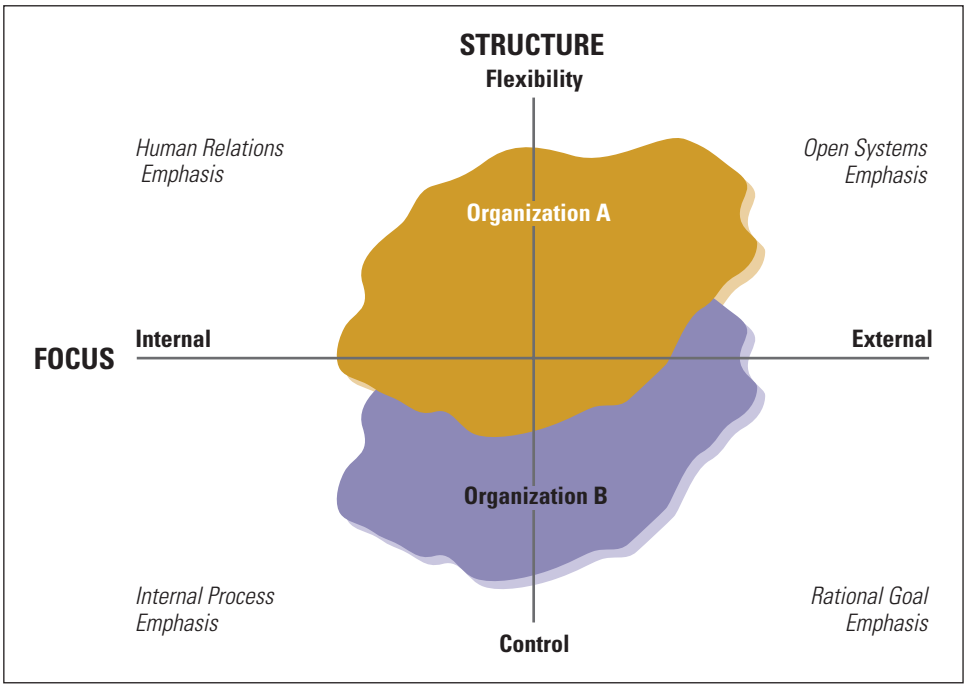

EXHIBIT 2.12
Effectiveness Values for Two Organizations

Organization A is a young organization concerned with finding a niche and becoming established in the external environment. Primary emphasis is given to flexibility, innovation, the acquisition of resources from the environment, and the satisfaction of external strategic constituents. This organization gives moderate emphasis to human relations and even less emphasis to current productivity and profits. Satisfying and adapting to the environment are more important. The attention given to open systems values means that the internal process emphasis is practically nonexistent. Stability and equilibrium are of little concern.

Organization B, in contrast, is an established business in which the dominant value is productivity and profits. This organization is characterized by planning and goal setting. Organization B is a large company that is well established in the environment and is primarily concerned with successful production and profits. Flexibility and human resources are not major concerns. This organization prefers stability and equilibrium to learning and innovation because it wants to maximize the value of its established customers.

3 **The best measures of business performance are financial.**

ANSWER: *Disagree.* If you can have only one type of measure of business performance, it might have to be financial. But diverse views of performance, such as using the competing values model, have proven to be more effective than financials alone because managers can understand and control the actions that cause business effectiveness. Financial numbers alone provide narrow and limited information.

ASSESS YOUR ANSWER

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Usefulness. The competing values model makes two contributions. First, it integrates diverse concepts of effectiveness into a single perspective. It incorporates the ideas of output goals, resource acquisition, and human resource development as goals the organization tries to accomplish. Second, the model calls attention to how effectiveness criteria are socially constructed from management values and shows how opposing values exist at the same time. Managers must decide which values they wish to pursue and which values will receive less emphasis. The four competing values exist simultaneously, but not all will receive equal priority. For example, a new, small organization that concentrates on establishing itself within a competitive environment will give less emphasis to developing employees than to the external environment.

The dominant values in an organization often change over time as organizations experience new environmental demands, new top leadership, or other changes. For example, when Samsung Group managers shifted the company's focus from quantity of sales to quality of products, it required a shift in dominant values.

IN PRACTICE

Samsung Group

Kobby Dagan/Shutterstock.com

Samsung once pursued sales of quantity-driven, low-end products as a primary goal. Managers emphasized stability, productivity, and efficiency. That all changed when Samsung Group chairman Kun-hee Lee visited a Los Angeles retailer in the early 1990s and found boxes of Samsung products gathering dust on back shelves while customers admired the cutting-edge products from other manufacturers.

Lee returned to Korea, ordered $50 million worth of inventory destroyed, and declared that quality and innovation would be the new guiding principles. The new approach, which emphasizes employee empowerment and training, creativity, flexibility, and innovative response to the external environment, has been highly successful. Today, Samsung is ranked among the world's most valuable brands and its smartphones challenge Apple's iPhone for style and innovativeness.

When Samsung flipped its focus from quantity to quality, it needed a new emphasis on people. "People Come First" and "A Company Is Its People" are mottos that guide the company, and talent management is emphasized to prepare a pool of next-generation leaders. New digital learning facilities and networking spaces have been created to foster creativity and innovation.[89]

The effectiveness values that guided Samsung in the past reflected a primarily internal process and rational goal emphasis. Managers valued stability, productivity, efficiency, and steady profits. However, chairman Kun-hee Lee saw that profitability would not continue for long unless things changed. He shifted the organization to effectiveness values that reflect a primarily human resource and open systems emphasis. Remember, all organizations are a mix of competing ideas, goals, and values. Goal emphasis and values change over time to meet new needs.

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REMEMBER THIS

- The competing values model balances a concern with various parts of the organization rather than focusing on one part.
- This approach acknowledges different areas of focus (internal, external) and structure (flexibility, stability) and allows managers to choose the values to emphasize in their organization.

KEY CONCEPTS

analyzer
competing values model
competitive advantage
core competence
defender
differentiation strategy
focus
goal approach
human relations emphasis
internal process approach
internal process emphasis
low-cost leadership strategy
mission
official goals
open systems emphasis
operating goals
organizational goal
prospector
rational goal emphasis
reactor
resource-based approach
scenario planning
social construct
strategic constituents approach
strategic intent
strategy
structure
SWOT analysis

DISCUSSION QUESTIONS

1. How might the top management of an organization use SWOT analysis or scenario planning to set goals and strategy? Explain.
2. How might a company's goals for employee development be related to its goals for innovation and change? To goals for productivity? Can you discuss how these types of goals might conflict in an organization?
3. What is a goal for the class for which you are reading this text? Who established this goal? Discuss how the goal affects your direction and motivation.
4. What is the difference between a goal and a strategy as defined in the text? Identify both a goal and a strategy for a campus or community organization with which you are involved.
5. Discuss the similarities and differences in the strategies described in Porter's competitive strategies and Miles and Snow's typology.
6. Do you believe mission statements and official goal statements provide an organization with genuine legitimacy in the external environment? When a company such as CVS (discussed in the chapter) makes a decision to stop selling cigarettes because that action conflicts with its mission statement, what do you see as the impact on public opinion? On future business? Discuss.
7. Suppose you have been asked to evaluate the effectiveness of the police department in a medium-sized community. Where would you begin, and how would you proceed? What effectiveness approach would you prefer?
8. What are the advantages and disadvantages of the resource-based approach versus the goal approach for measuring organizational effectiveness?
9. What are the similarities and differences between assessing effectiveness on the basis of competing values versus the strategic constituents approach? Explain.
10. A noted organization theorist once said, "Organizational effectiveness can be whatever top management defines it to be." Discuss.

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CHAPTER 2 WORKSHOP Identify Your Goal Preferences

Assume that you could design the perfect organization that reflected your values. What goals would receive priority in that organization?

Rank order the list of goals below from 1 to 10 to reflect the goals you consider most important to least important in your perfect organization.

Goal	Rank Order from 1 to 10
Employee Development	
Organization Stability	
Market Share Leader	
Creativity-Innovation	
Social Contribution	
High Morale/Satisfaction	
High Productivity	
Rapid Growth/Adaptability	
Profit Maximization	
Within the Law/Ethical	

Questions

1. Look at the integrated effectiveness model in Exhibit 2.11 and Exhibit 2.12. Allocate each goal above to the quadrant you think it fits. Which quadrant of the model reflects your highest goal values? Which quadrant ranks lowest?
2. Compare your ranking to other students and look for common themes. In what ways are your rankings different?
3. What organizational goals are important to you that are not on the list above? Where would you rank the missing goals?

CASE FOR ANALYSIS | The Addlington Gallery of Art

Locals referred to it—affectionately or sarcastically—as the "Adding Museum." Housed in the massive Romanesque-style former mansion of Horace and Margaret Addlington, the 100-year-old Addlington Gallery of Art had, by 2016, reached a tipping point of institutional and financial distress. Considered a point of civic and cultural pride, the home and its extensive collection of art had been the generous gift to the city's residents under terms of the legal wills of the childless industrial tycoon and his wife following their deaths in a 1910 motor-car accident.

The museum was established and controlled, as dictated in the will, by a Board of Directors comprised of old-moneyed families, friends of the Addlingtons, whose seats on the board historically passed from one generation to the next. In accordance with Horace and Margaret's desires to make their collections "accessible to all," the museum was, for several decades, free to the public. In its opening days and weeks, the rarefied opportunity for locals to "see inside the mansion," as much as to see the art, lured scores of visitors who endured long lines to enter the city's most palatial residence. Once the newness had worn off, however, the museum settled into a reputation as the cultural domain of the "la-de-dah art elite."

Over the decades, the cost of conserving the collection, and the mounting expenses of upkeep for the mansion and the gardens and grounds, spurred the Board to create an annual fund-raising gala that allowed society to admire the art and each other. Later, the necessity of admission fees to the museum added modestly to the overall financial situation, but visitor numbers remained stagnant and the majority of locals never ventured inside. *I always felt like, if I didn't drive up in a Mercedes, the staff didn't care whether or not I came. They were cold to the point of rudeness,* explained one long-time city resident.

Problems at the museum became public knowledge. Hirings and firings occurred at the whim of the Board, and on one occasion, the entire staff was fired without warning. The approaching 2010 centennial was marred by controversy and lawsuits over whether to sell a large portion of the collection in order to keep the museum afloat.

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The media and legal commotion over *losing* a collection that a majority of the city's residents had never seen sparked a generous outpouring of private financial support. During the campaign to *Save the Admirable Addlington,* the Board, in an effort to impress potential donors, actively sought, and received, the support of an adjacent private university with promises to build a collaborative partnership.

By 2013, with improved financial means to move the museum into a second century, the venerable Board, composed of member names stretching five generations, faced an organizational culture shock and a new and emboldened set of stakeholders. Under pressure to define the future direction of the museum and in preparation for selecting a new director, the Board hired two business students to conduct person-to-person interviews of stakeholders about the future vision and goals for the museum and the relationship of the university to the museum.

Excerpts from some of the more powerful comments by interviewees are listed below:

A major new private donor: *The museum has a reputation as an elitist, unfriendly institution, contrary to the intent of Horace and Margaret Addlington. My wife and I gave money with the expectation that the museum would, at last, embrace the vision of its benefactors of bringing the art to everyone. In order to accomplish this, the museum must have an educational component and promote visits from public schools in the area, and particularly serve the inner-city children who don't have access to art and who live within a mile of the museum. The snobbish, elitist atmosphere that extends from the Board through the ranks of the museum staff must be changed.*

A board member: *I've heard rumors that some people want to open this museum to scores of public school tours and after-school programs. I realize that school children need access to art and I sympathize with that need. But this is not a typical museum structure, it's a house that was constructed almost 120 years ago and has a variety of delicate surfaces and structural refinements that must be preserved and treasured for future generations. The upkeep of this building is tremendous with our current level of visitation. When you add several thousand school kids each year, the traffic through the building, the noise level within the building, compromises the structure and takes away from the experience of viewing great art. I can see creating educational programs that go out to the schools, but not bringing huge school groups here; and certainly not serving as some sort of after-school day care. No. I cannot see that.*

A university administrator: *The important thing is to add lively contemporary exhibits that will attract both university students and community adults and provide new insight and dialogue about current events. We can bring attention to the museum and spur dialogue by having an occasional controversial exhibit, such as Islamic art, and exhibits that appeal to Hispanics and African Americans. This approach would entail bringing in traveling exhibitions from major museums and loaning out portions of the Addlington collection in exchange.*

Head of the art history department: *The key thing is that the museum will not have the artistic resources or the financial resources to serve the community at large. We have a wonderful opportunity to integrate the museum with the academic faculty and make it a teaching institution. It can be a major resource for both undergraduate and graduate students in art education and in art history. Using the collections inside and the structure itself as a classroom, we can also work with engineering students, architecture students, and students in the liberal arts. This is a unique opportunity that will distinguish our art history department's mission from others in the country.*

A faculty member of the art history department: *The best use of the museum's relationship with the university is to concentrate on training PhD level students in art history and to support scholarly research. I strongly urge the museum to focus on graduate education, which would increase the stature of the university nationally. Graduate students would be involved in the design of exhibits that would fit their research. Trying to make the museum popular on campus or in the community will waste our limited resources. Our PhD students will be sought after by art history departments throughout the country, adding also to the prestige of the Addlington Gallery of Art.*

Head of the university's new department of public history: *It is imperative, upon selection of the new museum director, that the Board relinquish some of its power in the rethinking of the current collection and the selection and design of future exhibits to trained museum professionals—not art history experts. The professional expertise of the director and the staff; their knowledge of best practices in the field; their cognizance of trends and innovations in the museum field, will ultimately determine the success or failure of this museum.*

You have been invited to interview for the position of museum director and must now consider how you would answer questions that might arise during the interview process and how you would move the museum forward if you took the job.

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Questions

1. What are the possible purposes of the Addlington Gallery of Art? Which purpose would you choose for the museum?
2. Who are or should be the museum's customers?
3. What are the implications of the selected purpose and customers for the museum's structural design, the qualifications of its director, and its relationship to the university?

CASE FOR ANALYSIS | Millier Machine Parts & Services[90]

Larisa Harrison grimaced as she tossed her company's latest quarterly earnings onto the desk. When sales at Virginia-based Millier Machine Parts & Services surged past the $10 million mark some time back, Larisa was certain the company was well positioned for steady growth. Today Millier, which provides precision machine parts and service to the domestic corrugated box and paperboard industry, still enjoys a dominant market share, but sales and profits are showing clear signs of stagnation.

More than two decades ago, Larisa's grandfather loaned her the money to start the business and then handed over the barn on what had been the family's Shenandoah Valley farm to serve as her first factory. He had been a progressive thinker compared to many of his contemporaries who scoffed at the idea of a woman running a machine parts plant, and he saw no reason why a smart, ambitious 27-year-old woman couldn't run anything she wanted to. His old-fashioned friends no longer scoffed when Larisa became one of the major employers in the local area. Today, Millier operates from a 50,000 square-foot factory located near I-81 just a few miles from that old family barn. The business allowed Larisa to realize what had once seemed an almost impossible goal: She was making a good living without having to leave her close-knit extended family and rural roots. She also felt a sense of satisfaction at employing about 150 people, many of them neighbors. They were among the most hard-working, loyal workers you'd find anywhere. However, many of her original employees were now nearing retirement. Replacing those skilled workers was going to be difficult, she realized from experience. The area's brightest and best young people were much more likely to move away in search of employment than their parents had been. Those who remained behind just did not seem to have the work ethic Larisa had come to expect in her employees.

Other problems were looming as well. Millier's market share, once at a formidable 70 percent, was slipping fast, brought about not only by the emergence of new direct competitors but also by changes in the industry. The box and paperboard industry had never been particularly recession resistant, with demand fluctuating with manufacturing output. The rocky economy had hurt the whole industry, including Millier's largest customers. Added to that, alternative shipping products, such as flexible plastic films and reusable plastic containers, were becoming more prevalent. It remained to be seen how much of a dent they would make in the demand for boxes and paperboard. Even more worrying, consolidation in the industry had wiped out hundreds of the smaller U.S. plants that Millier once served, with many of the survivors either opening overseas facilities or entering into joint ventures abroad. On the bright side, the emergence of Internet retail sales at Amazon and Walmart was increasing demand for cardboard boxes among the survivors. The surviving manufacturers were investing in higher quality machines from Germany that broke down less frequently, thus requiring fewer of Millier's parts.

Millier was clearly at a crossroads, and its managers were arguing about which direction the company should take. If Millier wanted to grow, business as usual wasn't going to work. But no one could seem to agree on the best way to achieve growth. The marketing manager was pushing for moving into new products and services, perhaps even serving other industries, while the director of finance believed the plant needed to become more efficient, even lay off employees, and offer customers the lowest cost. Larisa cringed as she heard that statement because her focus was always on what was best for her employees. The finance director added that efficiency and profitability should be the key criteria by which Millier measured its performance, whereas the marketing manager vehemently argued that the company would be effective only if it focused on new customers and customer satisfaction in the changing industry environment, which would mean taking some financial risks. "We've already moved beyond corrugating machines to servicing other types of paperboard-making equipment. Why not become the all-round provider, serving any manufacturer that makes containers and packing materials, whether it's paper, plastic, or whatever?" It was truly an ambitious idea, but he was so fired up about it that he had investigated possible acquisitions and partnership opportunities. The finance director was livid. "If anyone is looking into mergers and acquisitions, it should be me, not the marketing manager," she had shouted at the most recent managers' meeting. Meanwhile, the vice president of manufacturing presented a plan for expanding market share by exporting parts globally, which set both the marketing manager and the finance director off. "Why haven't we even heard about this before now?" the marketing manager asked. "I'm not saying I disagree with it, but

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communication in this place is atrocious. I never even got a copy of the last finance report." The director of finance quickly shot back with a charge that the marketing manager didn't seem to care about profit and loss anyway so why should he need a copy of the report.

As Larisa considered the chaos into which the most recent meeting had degenerated, she thought back to her days in graduate school and realized that organization design was part of the problem. Millier had succeeded for two decades with a loose, even haphazard structure, because everyone seemed focused on building the business. People simply did what needed to be done. However, the company had never been under threat before. "Perhaps we just aren't as well organized as we need to be to handle the challenges Millier is facing," she thought. As she watched the last shift workers walk to their cars, Larisa pulled out a report that a consultant friend had developed for her a few months ago. The report emphasized:

- Millier rated very high on employee morale.
- Millier was rated low on innovation and change.
- The Millier culture emphasized production efficiency.
- The Millier culture was not intensely focused on developing new customers.
- Each department did its job well, but collaboration across departments was rated low to medium.
- Price competition would probably intensify as the customer base grew smaller.
- The industry would continue to change toward fewer paperboard machines and toward higher quality imported machines.

Larisa scribbled a few notes on a pad:

How should we decide what strategy to pursue?

Who should have authority and responsibility for what?

How do we improve communications?

What criteria should we use to measure performance and ensure accountability?

Larisa knew that as soon as she or her team could determine some answers, she would sleep at least a little better.

Questions

1. The managers seem to agree on the overall goal of growth. Which of their strategies would you recommend Millier take as the most likely way to achieve growth? Explain.
2. Using Exhibit 2.9, Four Approaches to Effectiveness, which emphasis would you say each manager is expressing?
3. How do you think the managers should go about resolving their difference with regard to their strategies?

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CHAPTER

3 Fundamentals of Organization Structure

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Learning Objectives

After reading this chapter you should be able to:

1. Define the three key components of organization structure.
2. Discuss the differences you see between the vertical and horizontal information-sharing aspects of structure.
3. Describe how relational coordination differs from other horizontal coordination mechanisms.
4. Identify the strengths and weaknesses of five common departmental grouping options, including functional, divisional, matrix, virtual, and holacracy.
5. Describe the symptoms of structural deficiency within an organization.

Chapter Outline

Organization Structure

Information-Sharing Perspective on Structure

Centralized Versus Decentralized • Vertical Information Sharing • Horizontal Information Sharing and Collaboration • Relational Coordination

Organization Design Alternatives

Required Work Activities • Reporting Relationships • Departmental Grouping Options

Functional, Divisional, and Geographic Designs

Functional Structure • Functional Structure with Horizontal Linkages • Divisional Structure • Geographic Structure

Matrix Structure

Conditions for the Matrix • Strengths and Weaknesses

Virtual Network Structure and Outsourcing

How the Structure Works • Strengths and Weaknesses

Holacracy Team Structure

Characteristics • Strengths and Weaknesses

Applications of Structural Design

Mix and Match • Structural Alignment • Symptoms of Structural Deficiency

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **A popular form of organizing is to have employees work on what they want in whatever department they choose so that motivation and enthusiasm stay high.**

I AGREE _____ **I DISAGREE** _____

2 **Committees and task forces whose members are from different departments are often worthless for getting things done.**

I AGREE _____ **I DISAGREE** _____

3 **Top managers are smart to maintain organizational control over the activities of key work units rather than contracting out some work unit tasks to other firms.**

I AGREE _____ **I DISAGREE** _____

Former Marine Captain Nate Fick compared the 13-person rifle squads of the United States Marine Corps to world-class dance troupes, saying, "Everybody's movement depends on everybody else's." Each squad was composed of a leader and three fire teams of four riflemen each. Writer Sam Walker, author of *The Captain Class: The Hidden Force That Creates the World's Greatest Teams,* called the Marine squads the "most brilliant tactical formation devised by any team in the last half century." Marine Corps Commandant Robert Neller doesn't necessarily disagree, but he blew up the long-standing structure of the squads by adding two new positions—an assistant squad leader and a systems operator focused on technology and intelligence—and reducing the squad size to 12. One rifleman was eliminated from each fire team. Today's military operations depend on battlefield intelligence pouring in from new technology, such as drones. So, in May of 2018, Neller "unveiled the most sweeping changes to Marine infantry combat organization in 70 years" to address new fighting conditions.[1]

Like managers in all organizations, military leaders undertake structural changes from time to time to meet shifting needs. Organization structure is one vital factor that helps organizations execute their strategies and achieve their goals. As mentioned in Chapter 1 of this text, Procter & Gamble is cutting divisions and reducing levels of management to increase speed and agility in the global environment. The streaming service Spotify has added a new position to its management structure, hiring a chief content officer to help the company move beyond music. A new CEO at Ralph Lauren Corporation restructured operations so that design, merchandising, sourcing, and marketing teams work together to move products from design to the sales floor more quickly.[2] Many companies use structural innovations such as cross-functional teams and matrix designs to achieve the coordination and flexibility they need. Teams, for example, are part of the strategy used by the Federal Bureau of Investigation (FBI) to combat terrorism. Like other organizations, the FBI must find ways to accomplish more with limited resources. One innovation was the creation of Flying Squads, which are teams of volunteer agents and support staff from various offices who are ready to spring into action when minimally staffed FBI offices around the world request assistance.[3] Some organizations, such as online retailer Zappos, have even moved to a bossless structure, in which all jobs, including those typically controlled and supervised by assigned managers, are handled by teams.

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Because of the complexity of today's environment, many organizations are more complex and amorphous than they used to be. Wyeth Pharmaceuticals formed a joint venture with Accenture called the Alliance for Clinical Data Excellence, designed to "bring together the best of both Wyeth and Accenture" for managing Wyeth's entire clinical testing operation—from protocol design to patient recruitment to site monitoring.[4] Accenture doesn't have a formal headquarters, no official branches, no permanent offices. The company's chief technologist is located in Germany, its head of human resources is in Chicago, the chief financial officer is in Silicon Valley, and most of its consultants are constantly on the move.[5] Wyeth and Accenture reflect the structural trend among organizations toward outsourcing, alliances, and virtual networking.

Still other firms continue to be successful with traditional functional structures that are coordinated and controlled through the vertical hierarchy. Organizations use a wide variety of structural alternatives to help them achieve their purpose and goals, and nearly every firm needs to undergo reorganization at some point to help meet new challenges. Structural changes are needed to reflect new strategies or respond to changes in other contingency factors introduced in Chapters 1 and 2: environment, technology, size and life cycle, and culture.

Purpose of This Chapter

This chapter introduces basic concepts of organization structure and shows how to design structure as it appears on the organization chart. First, we define structure and provide an overview of structural design. Next, an information-sharing perspective explains how to design vertical and horizontal linkages to provide needed information flow and coordination. The chapter then presents basic design options, followed by strategies for grouping organizational activities into functional, divisional, matrix, virtual network, or holacracy team structures. The final section examines how the application of basic structures depends on the organization's situation (various contingencies) and outlines the symptoms of structural misalignment.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Develop organization charts that describe task responsibilities, reporting relationships, and the grouping of individuals into departments. Provide sufficient documentation so that all people within the organization know to whom they report and how they fit into the total organization picture.

3.1 Organization Structure

The following three key components define **organization structure**:

1. Organization structure designates formal positions and reporting relationships, including the number of levels in the hierarchy and the span of control of managers and supervisors.
2. Organization structure identifies the grouping together of individuals into departments and of departments into the total organization.
3. Organization structure includes the design of systems to ensure effective communication, coordination, and integration of efforts across departments.[6]

These three elements of structure pertain to both vertical and horizontal aspects of organizing. For example, the first two elements are the structural *framework,* which is the vertical hierarchy.[7] The third element pertains to the pattern of *interactions* among organizational employees. An ideal structure encourages employees to provide horizontal information and coordination where and when it is needed.

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Organization structure is reflected in the organization chart. It isn't possible to see the internal structure of an organization the way we might see its manufacturing tools, offices, website, or products. Although we might see employees going about their duties, performing different tasks, and working in different locations, the only way to actually see the structure underlying all this activity is through the organization chart. The organization chart is the visual representation of a whole set of underlying activities and processes in an organization. Exhibit 3.1 shows a simple organization chart for a traditional organization. An organization chart can be quite useful in understanding how a company works. It shows the various parts of an organization, how they are interrelated, and how each position and department fits into the whole.

The concept of an organization chart, showing what positions exist, how they are grouped, and who reports to whom, has been around for centuries.[8] For example, diagrams outlining church hierarchy can be found in medieval churches in Spain. However, the use of the organization chart for business stems largely from the Industrial Revolution. As we discussed in Chapter 1, as work grew more complex and was performed by greater numbers of workers, there was a pressing need to develop ways of managing and controlling organizations. The growth of the railroads provides an example. After the collision of two passenger trains in Massachusetts in 1841, the public demanded better control of the operation. As a result, the board of directors of the Western Railroad took steps to outline "definite responsibilities for each phase of the company's business, drawing solid lines of authority and command for the railroad's administration, maintenance, and operation."[9]

Exhibit 3.2 shows an interesting example of an early organization chart created by Daniel McCallum for the Erie Railroad in 1855. Faced with financial strain and slumping productivity, McCallum created charts to explain the railroad's operations to investors and to show the division of responsibilities for superintendents along hundreds of miles of rail lines. McCallum divided the railroad into geographic divisions of manageable size, with each division headed by a superintendent.[10]

EXHIBIT 3.1
A Sample Organization Chart

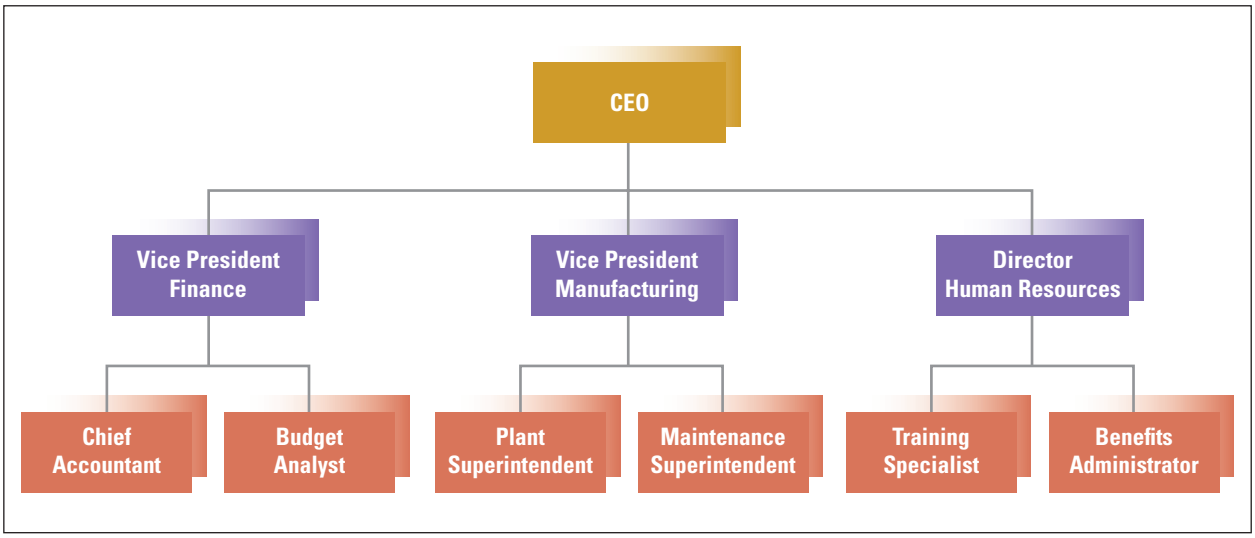

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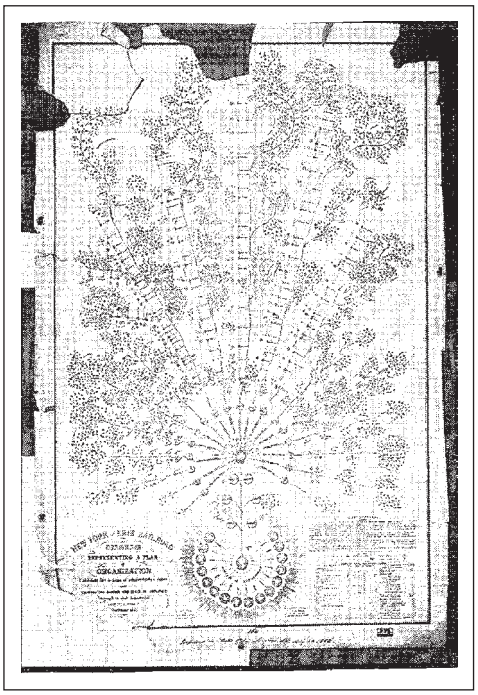
EXHIBIT 3.2
Organization Chart for the Erie Railroad, 1855



Source: Erie Railroad Organization Chart of 1855. Library of Congress, Haer, N.Y.

The type of organization structure that gradually grew out of these efforts in the late nineteenth and early twentieth centuries was one in which the CEO was placed at the top, and there was a clear hierarchy of authority extending to everyone else arranged in layers down below, as illustrated in Exhibit 3.1. The thinking and decision making are done by those at the top, and the physical work is performed by employees who are organized into distinct, functional departments. This structure was quite effective and became entrenched in business, nonprofit, and military organizations for most of the twentieth century. However, this type of vertical structure is not always effective, particularly in rapidly changing environments. Over the years, organizations have developed other structural designs, many of them aimed at increasing horizontal coordination and communication and encouraging adaptation to external changes. This chapter's BookMark suggests that new approaches to organizing and managing people are crucial for companies to attain durable competitive advantages in the twenty-first century.

ASSESS YOUR ANSWER

1 A popular form of organizing is to have employees work on what they want in whatever department they choose so that motivation and enthusiasm stay high.

ANSWER: *Disagree.* A small number of firms have tried this approach with some success, but a typical organization needs to structure its work activities, positions, and departments in a way that ensures work is accomplished and coordinated to meet organizational goals. Many managers try to give some consideration to employee choices as a way to keep enthusiasm high.

REMEMBER THIS

- Organization structure encompasses three key components. It designates formal positions and reporting relationships, identifies the grouping of individuals into departments, and provides mechanisms for linking and coordinating organizational elements into a coherent whole.
- The structure is reflected on the organization chart.
- The concept of an organization chart has been around for centuries, but the use of these charts for business stems largely from the Industrial Revolution.

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3.2 Information-Sharing Perspective on Structure

The organization should be designed to provide both vertical and horizontal information flow as necessary to accomplish the organization's overall goals. If the structure doesn't fit the information requirements of the organization, people either will have too little information or will spend time processing information that is not vital to their tasks, thus reducing effectiveness.[11] However, there is an inherent tension between vertical and horizontal mechanisms in an organization. Whereas vertical linkages are designed primarily for control, horizontal linkages are designed for coordination and collaboration, which usually means reducing control.

3.2a Centralized Versus Decentralized

One question is the level at which decisions are made in the organization, because that determines where information is needed. Centralization and decentralization pertain to the hierarchical level at which decisions are made. **Centralization** means that decision authority is located near the top of the organization. With **decentralization**, decision authority is pushed downward to lower organization levels.

Organizations can choose whether to orient toward a traditional organization designed for efficiency, which emphasizes vertical communication and control (a mechanistic design, as described in Chapter 1), or toward a more flexible learning organization, which emphasizes horizontal communication and coordination (an organic design). Exhibit 3.3 compares organizations designed for efficiency with those designed for learning and adaptation. An emphasis on efficiency and control is associated with specialized tasks, a hierarchy of authority, rules and regulations, formal reporting systems, few teams or task forces, and centralized decision making. Emphasis on learning and adaptation is associated with shared tasks; a relaxed hierarchy; few rules; face-to-face communication; many teams and task forces; and decentralized decision making.

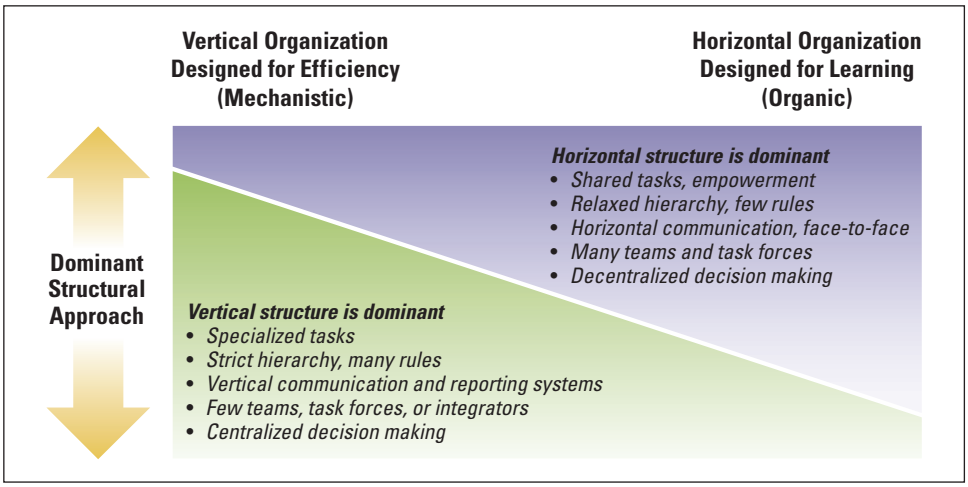

EXHIBIT 3.3
The Relationship of Organization Design to Efficiency Versus Learning Outcomes

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BOOKMARK 3.0 HAVE YOU READ THIS BOOK?

The Future of Management

By Gary Hamel with Bill Breen

Management breakthroughs such as the principles of scientific management, divisionalized organization structure, and using brand managers for horizontal coordination have created more sustained competitive advantage than any hot new product or service innovation, says Gary Hamel in *The Future of Management,* written with Bill Breen. Wait a minute—haven't those ideas been around since—well, *forever*? Exactly the point, says Hamel. In fact, he points out that many of today's managers are running twenty-first-century organizations using ideas, practices, and structural mechanisms invented a century or more ago. At that time, the principles of vertical hierarchy, specialization, bureaucratic control, and strong centralization were radical new approaches developed to solve the problem of inefficiency. They are too static, regimented, and binding today when the pace of change continues to accelerate. Today's organizations, Hamel argues, have to become "as strategically adaptable as they are operationally efficient."

SOME STRUCTURAL INNOVATORS

Hamel suggests that the practice of management must undergo a transformation akin to that which occurred with the Industrial Revolution and the advent of scientific management. Here, from *The Future of Management,* are a few examples that offer glimpses of what is possible when managers build structure around principles of community, creativity, and information sharing rather than strict hierarchy:

- *Whole Foods Market.* Teams are the basic organizational unit at Whole Foods, and they have a degree of autonomy nearly unprecedented in the retail industry. Each store is made up of eight or so self-directed teams that oversee departments such as fresh produce, prepared foods, dairy, or checkout. Teams are responsible for all key operating decisions, including pricing, ordering, hiring, and in-store promotions.
- *W. L. Gore.* W. L. Gore's innovation was to organize work so that good things happen whether managers are "in control" or not. Gore, best known for Gore-Tex fabric, lets employees decide what they want to do. There are no management layers, few titles, and no organization charts. As at Whole Foods, the core operating units are small teams, but at Gore people can choose which teams to work on and say no to requests from anyone. Gore also builds in strong accountability—people are reviewed by at least 20 of their peers every year.
- *Visa.* Everybody's heard of Visa, but few people know anything about the organization behind the brand. Visa is the world's first almost-entirely virtual company. In the early 1970s, a group of banks formed a consortium that today has grown into a global network of 21,000 financial institutions and more than 1.3 billion cardholders. The organization is largely self-organizing, continually evolving as conditions change.

HOW TO BE A MANAGEMENT INNOVATOR

Most companies have a system for product innovation, but Hamel notes that few have a well-honed process for management innovation. *The Future of Management* provides detailed steps managers can take to increase the chances of a breakthrough in management thinking. Hamel considers the rise of modern management and organization design the most important innovation of the twentieth century. It is time now, though, for twenty-first-century ideas.

The Future of Management, by Gary Hamel with Bill Breen, is published by Harvard Business School Press.

Organizations may have to experiment to find the correct degree of centralization or decentralization to meet their needs. For example, a study by William Ouchi found that three large school districts that shifted to a more flexible, decentralized structure, giving school principals more autonomy, responsibility, and control over resources, performed better and more efficiently than large districts that were highly centralized.[12] Walmart is experimenting with greater decentralization in some stores by having fewer managers and giving more decision-making authority to people on the sales floor. The company is testing several versions of the concept, called "Great Workplace," in around 100 Walmart Neighborhood Markets and smaller supercenters.[13] Even Japanese companies such as Toyota, which have a strong tradition of centralization, are seeing the power of decentralization for promoting a sense of ownership, as described in the following In Practice example.

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IN PRACTICE

Toyota

"We didn't have to go back to Japan for approval on everything," said Randy Stephens, the chief engineer at the Toyota Technical Center near Ann Arbor, Michigan, where a new version of the Avalon was designed and engineered. "We might go back to review the status of the project, but there is a feeling of ownership of this car here."

The new version of the Avalon, designed and engineered in Michigan and built in Kentucky, was promoted as the company's most American vehicle ever. It was the first prototype not developed in Japan, and it was a test of how well Toyota can decentralize decision making to the company's subsidiaries. Following years of crisis related to safety issues and recalls, Toyota managers have been gradually rebuilding a stronger company, which includes delegating responsibilities more globally.

The company was strongly criticized for its need to coordinate every decision regarding the safety issues and recalls from headquarters. Executives have since overhauled the quality control process and decentralized more decision making to regional managers in charge of safety in North America, Europe, and Asia.[14]

Although many decisions will still rest with executives at headquarters, Toyota has realized that some decisions need to be made close to the action. Regional managers believe the problems Toyota went through have given top executives freedom to take risks they might not have taken otherwise.[15]

However, not every organization should decentralize all decisions. Wells Fargo executives say too much decentralization is partly to blame for the ethical and legal trouble the company got into when employees were opening fake bank accounts, as described in the previous chapter. Within many companies, there is often a "tug of war between centralization and decentralization" as top executives want to centralize some operations to eliminate duplication and provide greater oversight, while business managers want to maintain decentralized control.[16] Managers are always searching for the best combination of vertical control and horizontal collaboration, centralization and decentralization, for their own situations.[17]

3.2b Vertical Information Sharing

Organization design should facilitate the communication among employees and departments that is necessary to accomplish the organization's overall task. Managers create *information linkages* to facilitate communication and coordination among organizational elements. **Vertical linkages** are used to coordinate activities between the top and bottom of an organization and are designed primarily for control of the organization. Employees at lower levels should carry out activities consistent with top-level goals, and top executives must be informed of activities and accomplishments at the lower levels. Organizations may use any of a variety of structural devices to achieve vertical linkage, including hierarchical referral, rules and plans, and formal management information systems.[18]

Hierarchical Referral. The first vertical device is the hierarchy, or chain of command, which is illustrated by the vertical lines in Exhibit 3.1. If a problem arises that employees don't know how to solve, it can be referred up to the next level in the hierarchy. When the problem is solved, the answer is passed back down to lower levels. The lines of the organization chart act as communication channels.

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Rules and Plans. The next linkage device is the use of rules and plans. To the extent that problems and decisions are repetitious, a rule or procedure can be established so employees know how to respond without communicating directly with their manager. Rules and procedures provide a standard information source enabling employees to be coordinated without actually communicating about every task. At PepsiCo's Gemesa cookie business in Mexico, for example, managers carefully brief production workers on goals, processes, and procedures so that employees themselves do most of the work of keeping the production process running smoothly, enabling the plants to operate with fewer managers.[19] Plans also provide standing information for employees. The most widely used plan is the budget. With carefully designed and communicated budget plans, employees at lower levels can be left on their own to perform activities within their resource allotment.

Vertical Information Systems. A **vertical information system** is another strategy for increasing vertical information capacity. Vertical information systems include the periodic reports, written information, and e-mails and other computer-based communications distributed to managers. Information systems make communication up and down the hierarchy more efficient.

In today's world of corporate financial scandals and ethical concerns, many top managers are considering strengthening their organization's linkages for vertical information and control. The other major issue in organizing is to provide adequate horizontal linkages for coordination and collaboration.

3.2c Horizontal Information Sharing and Collaboration

Horizontal communication overcomes barriers between departments and provides opportunities for coordination and collaboration among employees to achieve unity of effort and organizational objectives.[20] **Collaboration** means a joint effort between people from two or more departments to produce outcomes that meet a common goal or shared purpose and that are typically greater than what any of the individuals or departments could achieve working alone.[21] To understand the value of collaboration, consider the 2011 U.S. mission to raid Osama bin Laden's compound in Pakistan. The raid could not have succeeded without close collaboration between the Central Intelligence Agency (CIA) and the U.S. military. There has traditionally been little interaction between the nation's intelligence officers and its military officers, but the war on terrorism has changed that mindset. During planning for the bin Laden mission, military officers spent every day for months working closely with the CIA team in a remote, secure facility on the CIA campus. "This is the kind of thing that, in the past, people who watched movies thought was possible, but no one in the government thought was possible," one official later said of the collaborative mission.[22]

Horizontal linkage refers to communication and coordination horizontally across organizational departments. Its importance is articulated by comments made by Lee Iacocca when he took over Chrysler Corporation in the 1980s. The following quote might be more than three decades old, but it succinctly captures a problem that still occurs in organizations all over the world:

> *What I found at Chrysler were thirty-five vice presidents, each with his own turf. ... I couldn't believe, for example, that the guy running engineering departments wasn't in constant touch with his counterpart in manufacturing. But that's how it was. Everybody worked independently. I took one look at that system and I*

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Provide vertical and horizontal information linkages to integrate diverse departments into a coherent whole. Achieve vertical linkage through hierarchy referral, rules and plans, and vertical information systems. Achieve horizontal linkage through cross-functional information systems, liaison roles, task forces, full-time integrators, and teams.

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almost threw up. That's when I knew I was in really deep trouble. ... Nobody at Chrysler seemed to understand that interaction among the different functions in a company is absolutely critical. People in engineering and manufacturing almost have to be sleeping together. These guys weren't even flirting![23]

During his tenure at Chrysler, Iacocca pushed horizontal coordination to a high level. All the people working on a specific vehicle project—designers, engineers, and manufacturers, as well as representatives from marketing, finance, purchasing, and even outside suppliers—worked together on a single floor so they could easily communicate. Horizontal linkage mechanisms often are not drawn on the organization chart, but nevertheless are a vital part of organization structure. Small organizations usually have a high level of interaction among all employees, but in a large organization such as Chrysler, Google, Toyota, or Infosys, providing mechanisms to ensure horizontal information sharing is critical to effective collaboration, knowledge sharing, and decision making.[24] For example, poor coordination and lack of information sharing has been blamed for delaying Toyota's decisions and response time to quality and safety issues related to sticky gas petals, faulty brakes, and other problems.[25] The following devices are structural alternatives that can improve horizontal coordination and information flow.[26] Each device enables people to exchange information.

Information Systems. A significant method of providing horizontal linkage in today's organizations is the use of cross-functional information systems. Computerized information systems enable managers or frontline workers throughout the organization to routinely exchange information and update each other about progress, problems, opportunities, activities, or decisions. For example, at Veterans Administration (VA) hospitals around the country, a sophisticated system called Vista enables people all across the organization to access complete patient information and provide better care. By enabling close coordination and collaboration, technology helped transform the VA into one of the most cost-effective medical providers in the United States.[27]

Some organizations also encourage employees to use the company's information systems to build relationships across the organization, aiming to support and enhance ongoing coordination across projects and geographical boundaries. CARE International, one of the world's largest private international relief organizations, enhanced its personnel database to make it easy for people to find others with congruent interests, concerns, or needs. Each person in the database has listed past and current responsibilities, experience, language abilities, knowledge of foreign countries, emergency experiences, skills and competencies, and outside interests. The database makes it easy for people working across borders to seek each other out, share ideas and information, and build enduring horizontal connections.[28]

Liaison Roles. A higher level of horizontal linkage is direct contact between managers or employees affected by a problem. One way to promote direct contact is to create a special **liaison role**. A liaison person, sometimes called a coordinator, is located in one department but has the responsibility for communicating and achieving coordination and collaboration with another department. Liaison roles often exist between engineering and manufacturing departments because engineering has to develop and test products to fit the limitations of manufacturing facilities. An engineer's office might be located in the manufacturing area so the engineer is readily available for discussions with manufacturing supervisors about engineering

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problems with the manufactured products. A research and development person might sit in on sales meetings to coordinate new product development with what salespeople think customers are wanting.

Task Forces. Liaison roles usually link only two departments. When linkage involves several departments, a more complex device such as a task force is required. A **task force** is a temporary committee composed of representatives from each organizational unit affected by a problem.[29] Each member represents the interest of a department or division and can carry information from the meeting back to that department.

Task forces are an effective horizontal linkage device for temporary issues. They solve problems by direct horizontal collaboration and reduce the information load on the vertical hierarchy. Typically, they are disbanded after their tasks are accomplished. Organizations have used task forces for everything from organizing the annual company picnic to solving expensive and complex manufacturing problems. One example comes from Georgetown Preparatory School in North Bethesda, Maryland, which used a task force made up of teachers, administrators, coaches, support staff, and outside consultants to develop a flu preparedness plan.[30] After it acquired Time Warner, AT&T created numerous task forces to work on issues ranging from programming to data analytics.

IN PRACTICE
AT&T WarnerMedia

Things have been changing fast since AT&T bought Time Warner and rebranded it as WarnerMedia. At the time of the acquisition, Time Warner had three major divisions: HBO, Turner, and Warner Brothers. Soon after the acquisition deal was closed in 2018, AT&T executives created several committees, called "workstreams," made up of people from each of the three units, to analyze the rapid changes in the media industry and brainstorm ideas for how to address them.

FOOTAGE VECTOR PHOTO/Shutterstock.com

One workstream focused on the future of television and came up with the initial plan for a subscription video service to compete with Netflix. The idea was to keep HBO's standalone streaming service, HBO NOW, as a separate product, but introduce a new service with HBO at the center and additional content pulled from the rest of WarnerMedia's film and television libraries. The workstreams were the beginning of AT&T's efforts to break down boundaries and get the divisions working together. "I couldn't remember many times over the years where you'd have all three companies deciding strategy together," said a longtime Time Warner employee. John Stankey, WarnerMedia's CEO, and Robert Greenblatt, the former NBC Entertainment Chairman that Stankey put in charge of programming as Chief Content Officer, want the company to be more like successful firms such as Walt Disney Company and Comcast's NBC Universal, where there is much more cooperation and collaboration across divisions. Greenblatt warned employees that competitors were "eating our lunch," and pointed to the infighting and turf battles that had long characterized the relationships among Time Warner's divisions as one major reason for it. For instance, insiders say Turner once tried to collaborate with HBO on a streaming service but rivalries squashed the efforts. "This company in the past has tended to be a collection of separate entities . . . .," said Greenblatt. "It is really incumbent on us to figure out how to manage them in a really smart way together."[31]

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2 Committees and task forces whose members are from different departments are often worthless for getting things done.

ANSWER: *Disagree.* The point of cross-functional committees and task forces is to share information to coordinate their departmental activities. Meeting, talking, and disagreeing are the work of the committee. These groups should not try to "get things done" in the sense of being efficient.

ASSESS YOUR ANSWER

Full-time Integrator. A stronger horizontal linkage device is to create a full-time position or department solely for the purpose of coordination. A full-time **integrator** frequently has a title, such as product manager, project manager, program manager, or brand manager. Unlike the liaison person described earlier, the integrator does not report to one of the functional departments being coordinated. He or she is located outside the departments and has the responsibility for coordinating several departments. The brand manager for Planters Peanuts, for example, coordinates the sales, distribution, and advertising for that product.

The integrator can also be responsible for an innovation or change project, such as coordinating the design, financing, and marketing of a new product. An organization chart that illustrates the location of project managers for new product development is shown in Exhibit 3.4. The project managers are drawn to the side to indicate their separation from other departments. The arrows indicate project members assigned to the new product development. New Product A, for example, has a financial accountant assigned to keep track of costs and budgets. The engineering member provides design advice, and purchasing and manufacturing members represent their areas. The project manager is responsible for the entire project. He or she sees that the new product is completed on time, is introduced to the market, and achieves other project goals. The horizontal lines in Exhibit 3.4 indicate that project managers do not have formal authority over team members with respect to giving pay raises, hiring, or firing. Formal authority rests with the managers of the functional departments, who have direct authority over subordinates within their departments.

Integrators need excellent people skills. Integrators in most companies have a lot of responsibility but little authority. The integrator has to use expertise and persuasion to achieve coordination. He or she spans the boundary between departments and must be able to get people together, maintain their trust, confront problems, and resolve conflicts and disputes in the interest of the organization.[32]

Cross-Functional Teams. Project teams tend to be the strongest horizontal linkage mechanism. **Cross-functional teams** are permanent task forces made up of members from different functional areas and are often used in conjunction with a full-time integrator. When activities among departments require strong coordination and collaboration over a long period of time, a cross-functional team is often the solution. These teams are often formed as a foundation for an innovation by bringing together people from research, engineering, marketing, supply chain, and finance—each department that an innovation would affect. In companies that have implemented cross-functional teams successfully, including Apple, IKEA, and LEGO, managers clearly detail a specific and limited set of innovation goals so the team knows what it must do to be successful.[33] *Special project teams* may be used when organizations have a large-scale project, a major innovation, or a new product line. JetBlue Airways

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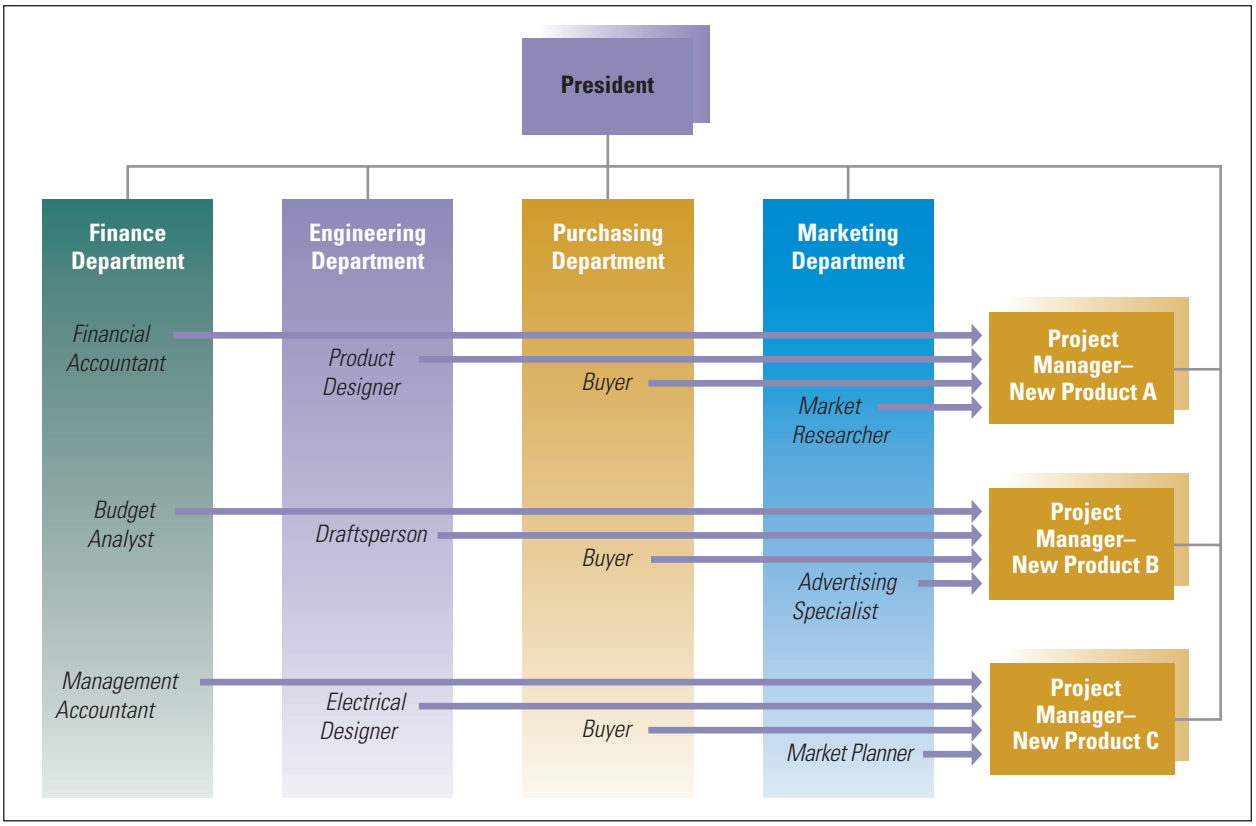
EXHIBIT 3.4
Project Manager Location in the Structure



put together a special project team made up of crew schedulers, systems operators, dispatchers, reservations agents, and other employees to revise how the airline handles and recovers from "irregular operations," such as severe weather. How effectively airlines manage and recover from these events dramatically affects performance and customer satisfaction, but effectiveness requires close coordination. The goal of JetBlue's special project team is to work out solutions to help the airline improve both regular on-time performance and its recovery time from major events.[34]

Many of today's companies use virtual cross-functional teams. A **virtual team** is one that is made up of organizationally or geographically dispersed members who are linked primarily through advanced information and communications technologies. Members use the Internet, collaboration software, and other digital technologies to work together rather than meet face to face.[35] Most companies, especially those that have virtual team members working in several different countries across time zones and cultures, have a virtual work space that members can access 24 hours a day.[36]

An illustration of how teams provide strong horizontal coordination is shown in Exhibit 3.5. Wizard Software Company develops and markets software for various web, desktop, and mobile applications, from games and social media products to financial services. Wizard uses teams to coordinate each product line across the research, programming, and marketing departments, as illustrated by the dashed lines and shaded areas in the exhibit. Members from each team meet at the beginning of each day as needed to resolve problems concerning customer needs, backlogs, programming changes, scheduling conflicts, and any other problem with the product line. Are you cut

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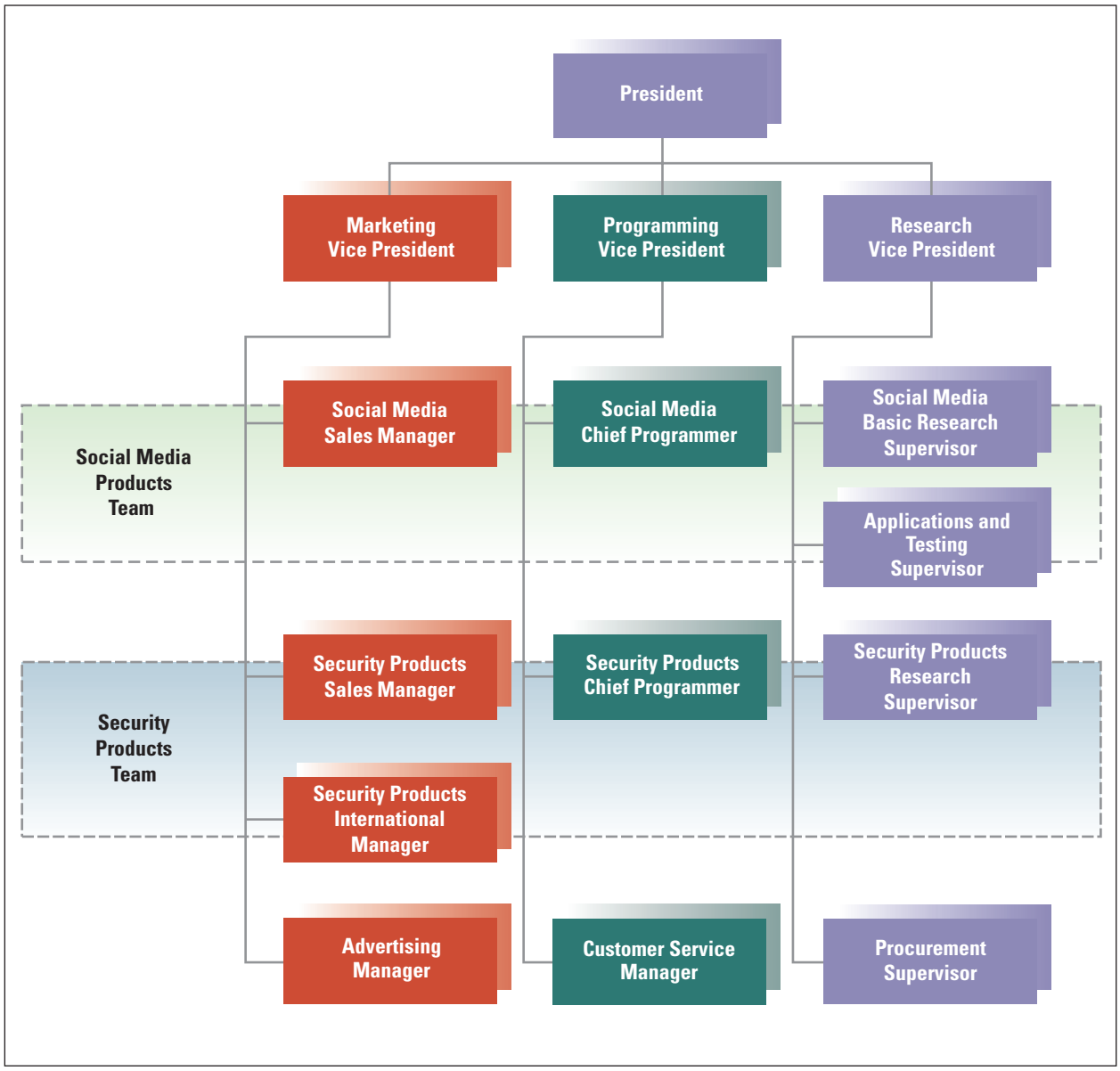
EXHIBIT 3.5
Teams Used for Horizontal Coordination at Wizard Software Company



out for horizontal teamwork? Complete the questionnaire in the "How Do You Fit the Design?" box to assess your feelings about working on a team.

Exhibit 3.6 summarizes the mechanisms for achieving horizontal linkages. These devices represent alternatives that managers can select to increase horizontal coordination and collaboration in any organization. The higher-level devices provide more horizontal information capacity, although the cost to the organization in terms of time and human resources is greater. If horizontal communication is insufficient, departments will find themselves out of synchronization and will not contribute to the overall goals of the organization. When the amount of horizontal coordination needed is high, managers should select higher-level mechanisms.

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HOW DO YOU FIT THE DESIGN?

THE PLEASURE/PAIN OF WORKING ON A TEAM

Your approach to your job or schoolwork may indicate whether you thrive on a team. Answer the following questions about your work preferences. Please answer whether each item is Mostly True or Mostly False for you.

	Mostly True	Mostly False
1. I prefer to work on a team rather than do individual tasks.	_____	_____
2. Given a choice, I try to work by myself rather than face the hassles of group work.	_____	_____
3. I enjoy the personal interaction when working with others.	_____	_____
4. I prefer to do my own work and let others do theirs.	_____	_____
5. I get more satisfaction from a group victory than an individual victory.	_____	_____
6. Teamwork is not worthwhile when people do not do their share.	_____	_____
7. I feel good when I work with others, even when we disagree.	_____	_____
8. I prefer to rely on myself rather than others to do a job or assignment.	_____	_____

Scoring: Give yourself one point for each odd-numbered item you marked as Mostly True and one point for each even-numbered item you marked Mostly False. Your score indicates your preference for teamwork versus individual work. If you scored 2 or fewer points, you definitely prefer individual work. A score of 7 or above suggests that you prefer working in teams. A score of 3–6 indicates comfort working alone and in a team.

Interpretation: Teamwork can be either frustrating or motivating depending on your preference. On a team you will lose some autonomy and have to rely on others who may be less committed than you. On a team you have to work through other people and you lose some control over work procedures and outcomes. On the other hand, teams can accomplish tasks far beyond what an individual can do, and working with others can be a major source of satisfaction. If you definitely prefer individual work, then you would likely fit better in a functional structure within a vertical hierarchy or in the role of individual contributor. If you prefer teamwork, then you are suited to work in the role of a horizontal linkage, such as on a task force or as an integrator, and would do well in a holacracy team or matrix organization structure.

Source: Based on Jason D. Shaw, Michelle K. Duffy, and Eric M. Stark, "Interdependence and Preference for Group Work: Main and Congruence Effects on the Satisfaction and Performance of Group Members," *Journal of Management* 26, no. 2 (2000), 259–279.

3.2d Relational Coordination

The highest level of horizontal coordination illustrated in Exhibit 3.6 is relational coordination. **Relational coordination** refers to "frequent, timely, problem-solving communication carried out through relationships of shared goals, shared knowledge, and mutual respect."[37] Relational coordination isn't a device or mechanism like the other elements listed in Exhibit 3.6, but rather is part of the very fabric and culture of the organization. In an organization with a high level of relational coordination, people share information freely across departmental boundaries, and people interact on a continuous basis to share knowledge and solve problems. Coordination is carried out through a web of ongoing positive relationships rather than because of formal coordination roles or mechanisms.[38] Employees coordinate and collaborate directly with each other across units.

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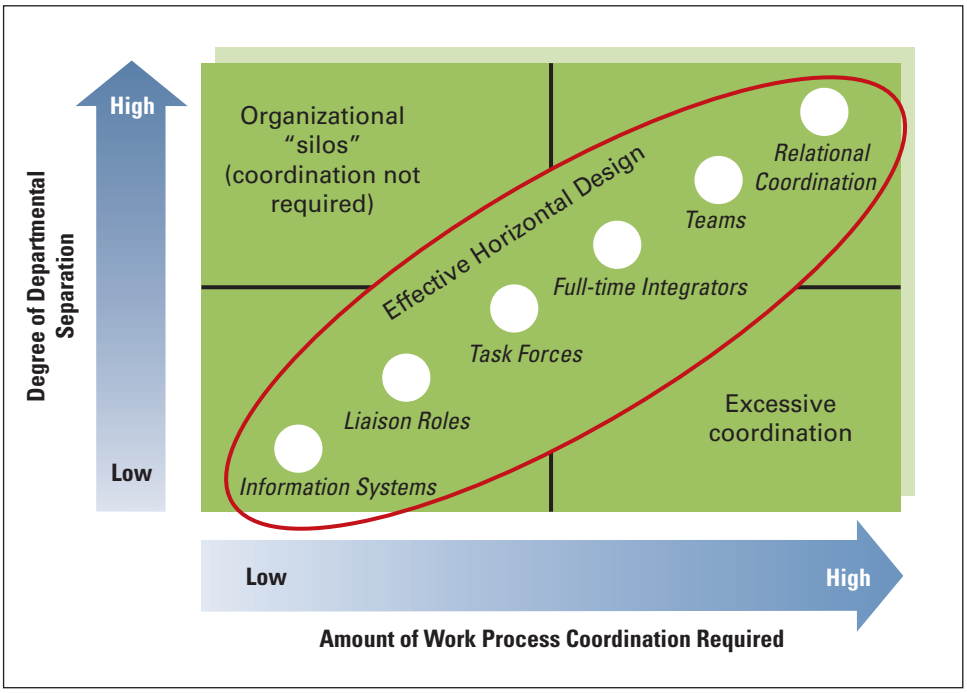

EXHIBIT 3.6
Ladder of Mechanisms for Horizontal Linkage and Coordination

Sources: Based on Exhibit 1 in Nicolay Worren, "Hitting the Sweet Spot Between Separation and Integration in Organization Design," *People & Strategy* 34, no. 1 (2011), 24–30; and Richard L. Daft, *Organization Theory and Design,* 11th ed. (Cincinnati, OH: Cengage/Southwestern), 106.

Building relational coordination into the fabric of the organization requires the active role of managers. Managers invest in training people in the skills needed to interact with one another and resolve cross-functional conflicts, build trust and credibility by showing they care about employees, and intentionally foster relationships based on shared goals rather than emphasizing goals of the separate departments. People are given freedom from strict work rules so they have the flexibility to interact and contribute wherever they are needed, and rewards are based on team efforts and accomplishments. Frontline supervisors have small spans of control so they can develop close working relationships with subordinates and coach and mentor employees. Managers also create specific cross-functional roles that promote coordination across boundaries. Southwest Airlines provides a good illustration.

IN PRACTICE

Southwest Airlines

Airlines face many challenges, but one that they face hundreds of times a day is getting airplanes loaded and off the ground safely and on time. Flight departure is a highly complex process. It involves numerous employees from various departments—such as ticket agents, pilots, flight attendants, baggage handlers, gate agents, mechanics, ramp agents, and fuel attendants—performing multiple tasks within a limited time period, under uncertain and ever-changing conditions. If all these groups aren't tightly coordinated, a successful on-time departure is difficult to achieve.

Southwest Airlines has the shortest turnaround time in the business, partly because managers promote relational coordination to achieve superior on-time performance and a high level of customer satisfaction. In any airline, there can be serious disagreements among employees about who is to blame when a flight is delayed, so Southwest managers created what they call *team delay*. Rather than searching for who is to blame when something goes wrong, the team delay is used to point out problems in coordination between

(*continued*)

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various groups. Emphasis on the team focuses everyone on the shared goals of on-time departure, safety, accurate baggage handling, and customer satisfaction. Because delay becomes a team problem, people are motivated to work closely together and coordinate their activities rather than looking out for themselves and trying to avoid or shift blame. Supervisors work closely with employees, but their role is less about "being the boss," and more about enabling learning and helping people do their jobs. Southwest uses a small supervisory span of control—about one supervisor for every eight or nine frontline employees—so that supervisors have the time to coach and assist employees, who are viewed as internal customers.[39]

By using practices that facilitate relational coordination, Southwest managers ensure that all the departments involved in flight departure are tightly coordinated. When relational coordination is high, people share information and coordinate their activities without having to have bosses or formal mechanisms telling them to do so.

When he was deputy commander of U.S. forces in Afghanistan, four-star Army General David M. Rodriguez (currently commander of the United States Africa Command) was known to foster relational coordination among U.S. and Afghan military leaders as well as low-ranking commanders, civilian leaders, and others. His operations center had the feel of a newsroom, in which people eagerly talked to one another and shared their knowledge. Guidelines from high-ranking officers got bottom-up refinement from captains and sergeants. Rodriguez understood that people have to "work together and figure out how to maximize the effectiveness of the team."[40]

REMEMBER THIS

- Linking the organization into a coherent whole requires the use of information systems and communication linkage devices in addition to the organization chart.
- Organization structure can be designed to provide vertical and horizontal information linkages based on the information processing required to meet the organization's overall goal.
- Managers can choose whether to orient toward a traditional organization designed for efficiency, which emphasizes vertical linkages such as hierarchy, rules and plans, and formal information systems (a mechanistic design), or toward a more flexible organization designed for learning and adaptation, which emphasizes horizontal communication and coordination (an organic design).
- Organizations provide horizontal linkages through cross-functional information systems, liaison roles, temporary task forces, full-time integrators, cross-functional teams, and by creating the conditions to enable relational coordination.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Recognize that the strongest horizontal linkage mechanisms are more costly in terms of time and human resources but are necessary when the organization needs a high degree of horizontal coordination to achieve its goals. When very high levels of coordination and knowledge sharing are needed, build relational coordination into the culture of the organization.

3.3 Organization Design Alternatives

The overall design of organization structure indicates three things: required work activities, reporting relationships, and departmental groupings.

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3.3a Required Work Activities

Departments are created to perform tasks considered strategically important to the company. In a typical manufacturing company, for example, work activities fall into a range of functions that help the organization accomplish its goals, such as a human resource department to recruit and train employees, a purchasing department to obtain supplies and raw materials, a production department to build products, and a sales department to sell products. As organizations grow larger and more complex, managers find that more functions need to be performed. Organizations typically define new positions, departments, or divisions as a way to accomplish new tasks deemed valuable by the organization. Recall that Spotify has added a chief content officer to move beyond streaming music. British oil giant BP added a new safety division in the wake of the Deepwater Horizon oil spill. Amazon created an in-house logistics department to handle its own shipping and distribution. Some observers think Amazon's delivery network will eventually become a business that will challenge UPS and FedEx in delivering merchandise and packages for other companies.[41]

3.3b Reporting Relationships

Once required work activities and departments are defined, the next question is how these activities and departments should fit together in the organizational hierarchy. Reporting relationships, often called the *chain of command,* are represented by vertical lines on an organization chart. The chain of command should be an unbroken line of authority that links all persons in an organization and shows who reports to whom. In a large organization such as General Electric, BP, Amazon, or L'Oreal, 100 or more charts might be needed to identify reporting relationships among thousands of employees. The definition of departments and the drawing of reporting relationships define how employees are to be grouped into departments.

3.3c Departmental Grouping Options

Options for departmental grouping, including functional grouping, divisional grouping, multifocused grouping, virtual network grouping, and holacracy team grouping, are illustrated in Exhibit 3.7. **Departmental grouping** affects employees because they share a common supervisor and common resources, are jointly responsible for performance, and tend to identify and collaborate with one another.[42]

Functional grouping places together employees who perform similar functions or work processes or who bring similar knowledge and skills to bear. For example, all marketing people work together under the same supervisor, as do all manufacturing employees, all human resources people, and all engineers. For an Internet company, all the people associated with maintaining the website might be grouped together in one department. In a scientific research firm, all chemists may be grouped in a department different from biologists because they represent different disciplines.

Divisional grouping means people are organized according to what the organization produces. All the people required to produce toothpaste—including personnel in marketing, manufacturing, and sales—are grouped together under one executive.

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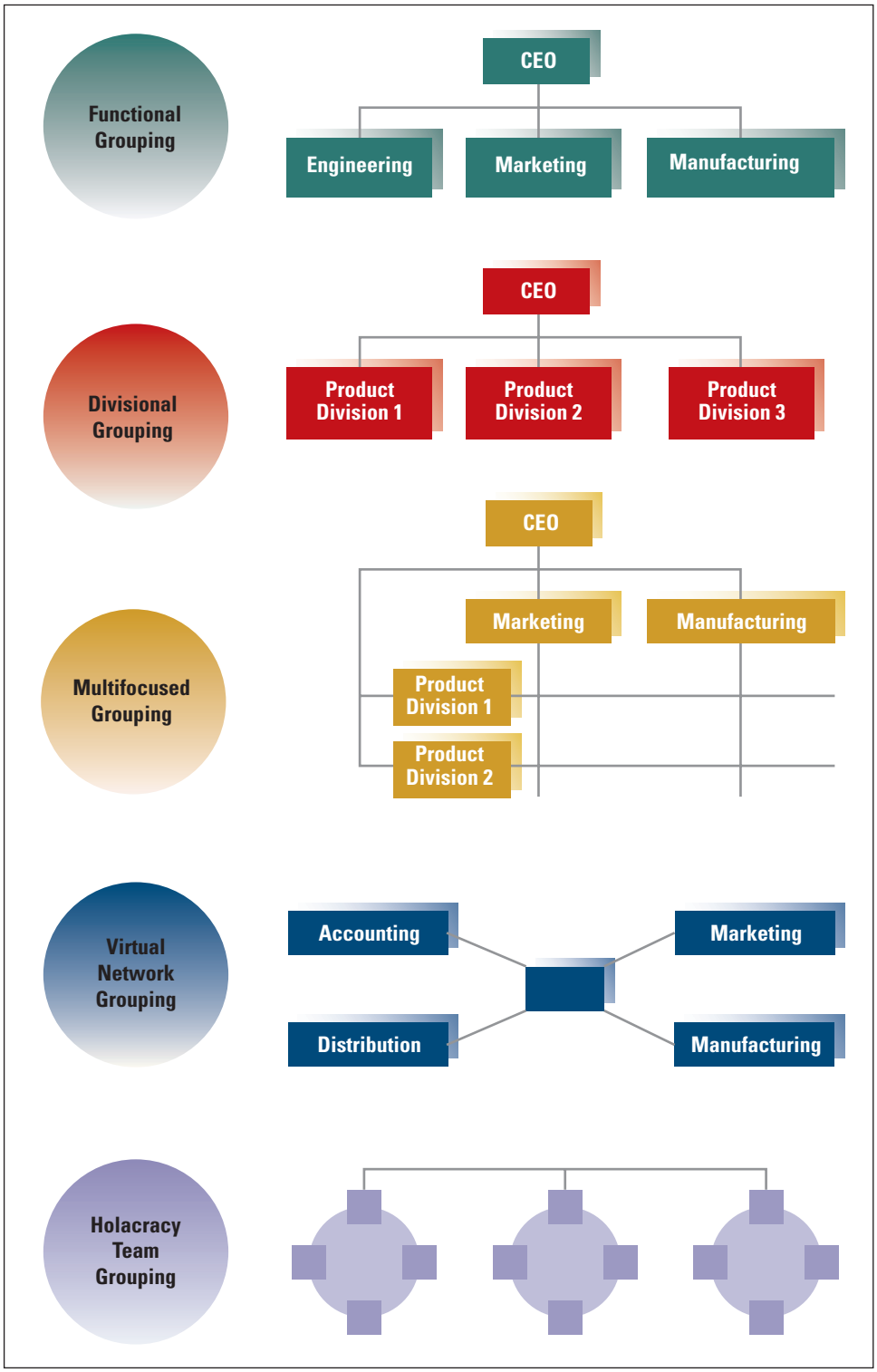
EXHIBIT 3.7
Structural Design Options for Grouping Employees into Departments



Source: Adapted from David Nadler and Michael Tushman, *Strategic Organization Design* (Glenview, IL: Scott Foresman, 1988), 68.

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In huge corporations, such as AT&T, some product or service lines may represent independent businesses, such as AT&T Communications (mobile and other communication services), WarnerMedia (television and movies), and Xander (advertising solutions).

Matrix grouping means an organization embraces two or more structural grouping alternatives simultaneously. An organization may need to group by function and product divisions simultaneously or might need to combine characteristics of several structural options. This structural form is often called a *matrix* structure. The matrix structure will be discussed in more detail later in this chapter.

With **virtual network grouping**, the organization is a loosely connected cluster of separate components. In essence, departments are separate organizations that are electronically connected for the sharing of information and completion of tasks. Departments can be spread all over the world rather than located together in one geographic location.

Holacracy team grouping is the most recent approach to departmental grouping. With this grouping, the entire organization is made up of self-managing teams that include the people needed to accomplish a specific task or activity.

The organizational forms described in Exhibit 3.7 provide the overall options within which a company's organization chart is drawn and the detailed structure is designed. Each structural design alternative has significant strengths and weaknesses, to which we now turn.

REMEMBER THIS

- The overall design of organization structure indicates three things: required work activities, reporting relationships, and departmental groupings.
- Alternatives for grouping employees and departments into overall structural design include functional grouping, divisional grouping, matrix grouping, virtual network grouping, and holacracy team grouping.

3.4 Functional, Divisional, and Geographic Designs

Functional grouping and divisional grouping are the two most common approaches to structural design.

3.4a Functional Structure

In a **functional structure**, also called a U-form (unitary), activities are grouped together by common function from the bottom to the top of the organization.[43] All engineers are located in the engineering department, and the vice president of engineering is responsible for all engineering activities. The same is true in marketing, R&D, and manufacturing. An example of the functional organization structure was shown in Exhibit 3.1 earlier in this chapter.

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With a functional structure, all human knowledge and skills with respect to specific activities are consolidated, providing a valuable depth of knowledge for the organization. This structure is most effective when in-depth expertise is critical to meeting organizational goals, when the organization needs to be controlled and coordinated through the vertical hierarchy, and when efficiency is important. The structure can be quite effective if there is little need for horizontal coordination. Exhibit 3.8 summarizes the strengths and weaknesses of the functional structure.

One strength of the functional structure is that it promotes economy of scale within functions. Economy of scale results when all employees are located in the same place and can share facilities. Producing all products in a single plant, for example, enables the plant to acquire the latest machinery. Constructing only one facility instead of separate facilities for each product line reduces duplication and waste. The functional structure also promotes in-depth skill development of employees. Employees are exposed to a range of functional activities within their own department.[44] The main weakness of the functional structure is a slow response to environmental changes that require coordination across departments. The vertical hierarchy becomes overloaded. Decisions pile up, and top managers do not respond fast enough. Other disadvantages of the functional structure are that innovation is slow because of poor coordination, and each employee has a restricted view of overall goals.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

When designing overall organization structure, choose a functional structure when efficiency is important, when in-depth knowledge and expertise are critical to meeting organizational goals, and when the organization needs to be controlled and coordinated through the vertical hierarchy. Use a divisional structure in a large organization with multiple product lines and when you wish to give priority to product goals and coordination across functions.

3.4b Functional Structure with Horizontal Linkages

Some organizations perform very effectively with a functional structure, and organizing by functions is still the prevalent approach to organization design.[45] However, in today's fast-moving world, very few companies can be successful with a strictly functional structure. For example, Watershed Asset Management is organized by functions such as legal, accounting, and investment, but to ensure coordination and collaboration, founder Meridee A. Moore has everyone sit in one big open room. "There's not much that is distilled or screened," she says. "When we're working on something, there's a lot of back and forth."[46] For a small organization, this informal coordination works fine, but as organizations grow larger, they typically need stronger mechanisms for horizontal linkage.

Managers improve horizontal coordination by using information systems, liaison roles, full-time integrators or project managers (illustrated in Exhibit 3.4), task forces, or teams (illustrated in Exhibit 3.5), and by creating the conditions that encourage relational coordination. One interesting use of horizontal linkages occurred at

EXHIBIT 3.8
Strengths and Weaknesses of Functional Organization Structure

Strengths	Weaknesses
1. Allows economies of scale within functional departments	1. Slow response time to environmental changes
2. Enables in-depth knowledge and skill development	2. May cause decisions to pile on top; hierarchy overload
3. Enables organization to accomplish functional goals	3. Leads to poor horizontal coordination among departments
4. Is best with only one or a few products	4. Results in less innovation
	5. Involves restricted view of organizational goals

Source: Based on Robert Duncan, "What Is the Right Organization Structure?" *Organizational Dynamics* (Winter 1979), 59–80.

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Karolinska Hospital in Stockholm, Sweden, which had 47 functional departments. Even after top executives cut that down to 11, coordination was still inadequate. The top executive team set about reorganizing workflow at the hospital around patient care. Instead of bouncing a patient from department to department, Karolinska now envisions the illness to recovery period as a process with "pit stops" in admissions, X-ray, surgery, and so forth. The most interesting aspect of the approach is the position of nurse coordinator. Nurse coordinators serve as full-time integrators, troubleshooting transitions within or between departments. The improved horizontal coordination dramatically improved productivity and patient care at Karolinska.[47] The hospital is effectively using horizontal linkages to overcome some of the disadvantages of the functional structure.

3.4c Divisional Structure

With a **divisional structure**, also called an M-form (multidivisional) or a decentralized form, separate divisions can be organized with responsibility for individual products, services, product groups, major projects or programs, divisions, businesses, or profit centers.[48] This structure is sometimes also called a product structure or strategic business unit structure. The distinctive feature of a divisional structure is that grouping is based on *organizational outputs*. For example, LEGO Group shifted from a functional structure to a divisional structure with three product divisions: DUPLO, with its big bricks for the youngest children; LEGO construction toys; and a third category for other forms of LEGO play materials such as buildable jewelry. Each division contained the functional departments necessary for that toy line.[49] United Technologies Corporation (UTC), which is among the 50 largest U.S. industrial firms, has numerous divisions, including Carrier (air conditioners and heating), Otis (elevators and escalators), Pratt & Whitney (aircraft engines), and Collins Aerospace (technology products for the aerospace and defense industries).[50] The Chinese online-commerce company Taobao, which is a division of Alibaba Group, is further separated into three divisions that provide three different types of services: linking individual buyers and sellers; a marketplace for retailers to sell to consumers; and a service for people to search across Chinese shopping websites.[51]

Organizations tend to shift from functional to divisional structures as they become more complex.[52] The difference between a divisional structure and a functional structure is illustrated in Exhibit 3.9. The functional structure can be redesigned into separate product groups, and each group contains the functional departments of R&D, manufacturing, accounting, and marketing. Coordination is maximized across functional departments within each product group. The divisional structure promotes flexibility and change because each unit is smaller and can adapt to the needs of its environment. Moreover, the divisional structure *decentralizes* decision making because the lines of authority converge at a lower level in the hierarchy. The functional structure, by contrast, is *centralized* because it forces decisions all the way to the top before a problem affecting several functions can be resolved.

Strengths and weaknesses of the divisional structure are summarized in Exhibit 3.10. The divisional organization structure is excellent for achieving coordination across functional departments. It works well when organizations can no longer be adequately controlled through the traditional vertical hierarchy and when goals are oriented toward adaptation and change. When Google grew from a small search engine into a giant company operating in areas as diverse as biotechnology and finance, co-founder and CEO Larry Page reorganized into a type of divisional structure to keep adaptation and innovation a thriving part of all the businesses.

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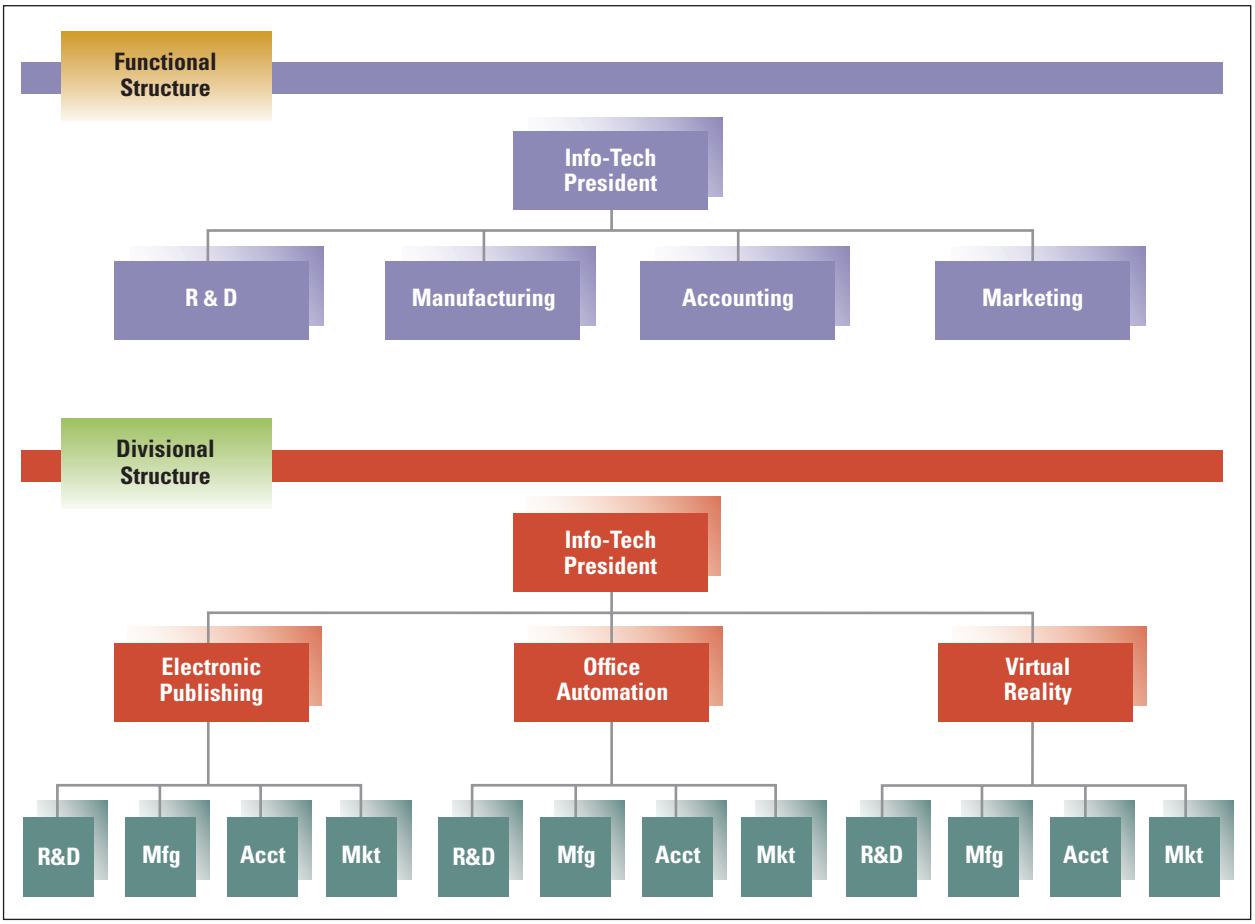
EXHIBIT 3.9
Reorganization from Functional Structure to Divisional Structure at Info-Tech



IN PRACTICE

Google and Alphabet

Elijah Nouvelage/File Photo/Reuters

Google was founded as a company that did Internet search. Yet by 2015, it was involved in everything from pharmaceuticals to self-driving cars. Google's then-CEO Larry Page and his co-founder Sergey Brin decided to restructure the various businesses under a new parent company, called Alphabet, to give managers in the businesses more autonomy and keep the companies innovative and adaptable. The largest division of Alphabet is Google, which includes the traditional business of search and advertising along with other activities. Other divisions include Verily, a life-sciences research organization; self-driving car unit Waymo; CapitalG, which provides late stage venture capital funding; and X Development, which focuses on various experimental products and services. Each business unit has its own goals and budget, each contains all the functions needed to perform its tasks, and

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each has its own CEO and management team. Management style and culture may also vary among the divisions. For instance, although Google offers napping pods for employees, not all divisions of Alphabet follow suit.

The idea behind Alphabet is that by being smaller and more independent, each unit can be nimbler and more innovative to serve the fast-moving needs and desires of customers. "There can be a lot of cross-company confusion when companies get too big, and this will allow people to build the right set of products for the right users . . ." said Wesley Chan, a Google veteran who is now a partner at venture capital firm Felicis Ventures.[53]

Google co-founders Page and Brin serve as CEO and President of Alphabet. Page says the structure will continue to evolve. Many companies find that they need to restructure every few years as they grow larger. Giant, complex organizations such as General Electric and Johnson & Johnson are subdivided into a series of smaller, self-contained organizations for better control and coordination. In these large, complex companies, the units are sometimes called divisions, businesses, or strategic business units. Johnson & Johnson is organized into three major divisions: Consumer Products, Medical Devices and Diagnostics, and Pharmaceuticals, yet within those three major divisions are more than 250 separate operating units in 57 countries.[54] Some U.S. government organizations also use a divisional structure to better serve the public. One example is the Internal Revenue Service, which wanted to be more customer oriented. The agency shifted its focus to informing, educating, and serving the public through four separate divisions serving distinct taxpayer groups—individual taxpayers, small businesses, large businesses, and tax-exempt organizations. Each division has its own budget, personnel, policies, and planning staffs that are focused on what is best for each particular taxpayer segment.[55]

The divisional structure has several strengths.[56] This structure is suited to fast change in an unstable environment and provides high product or service visibility. Since each product line has its own separate division, customers are able to contact the correct division and achieve satisfaction. Coordination across functions is excellent. Each product or service can adapt to requirements of individual customers or regions. The divisional structure typically works best in organizations that have multiple products or services and enough personnel to staff separate functional units. Decision making is pushed down to the divisions. Each division is small enough to be quick on its feet, responding rapidly to changes in the market. Verizon reorganized into three divisions serving different types of customers—Verizon Consumer Group, Verizon Business Group, and Verizon Media Group—to better respond to changing customer needs.

Strengths	Weaknesses
1. Suited to fast change in unstable environment	1. Eliminates economies of scale in functional departments
2. Leads to customer satisfaction because product responsibility and contact points are clear	2. Leads to poor coordination across product lines
3. Involves high coordination across functions	3. Eliminates in-depth competence and technical specialization
4. Allows units to adapt to differences in products, regions, customers	4. Makes integration and standardization across product lines difficult
5. Best in large organizations with several products	
6. Decentralizes decision making	

EXHIBIT 3.10 Strengths and Weaknesses of Divisional Organization Structure

Source: Based on Robert Duncan, "What Is the Right Organization Structure?" *Organizational Dynamics* (Winter 1979).

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One disadvantage of using divisional structuring is that the organization loses economies of scale. Instead of 50 research engineers sharing a common facility in a functional structure, 10 engineers may be assigned to each of five product divisions. The critical mass required for in-depth research is lost, and physical facilities have to be duplicated for each product line. Another problem is that product lines become separate from each other, and coordination across product lines can be difficult. As a Johnson & Johnson executive once said, "We have to keep reminding ourselves that we work for the same corporation."[57]

Some companies that have a large number of divisions have had real problems with cross-unit coordination. Sony lost the digital music player business to Apple partly because of poor coordination. With the introduction of the iPod, Apple quickly captured 60 percent of the U.S. market versus 10 percent for Sony. The digital music business depends on seamless coordination. Sony's Walkman did not even recognize some of the music sets that could be made with the company's SonicStage software and thus didn't mesh well with the division selling music downloads.[58] Unless effective horizontal mechanisms are in place, a divisional structure can hurt overall performance. One division may produce products or programs that are incompatible with products sold by another division, as at Sony. Customers can become frustrated when a sales representative from one division is unaware of developments in other divisions. Task forces and other horizontal linkage devices are needed to coordinate across divisions. A lack of technical specialization is also a problem in a divisional structure. Employees identify with the product line rather than with a functional specialty. R&D personnel, for example, tend to do applied research to benefit the product line rather than basic research to benefit the entire organization.

The problem of coordination and collaboration is amplified in the international arena because organizational units are differentiated not only by goals and work activities, but also by geographical distance, time differences, cultural values, and perhaps language. How can managers ensure that needed coordination and collaboration will take place in their company, both domestically and globally? Coordination is the outcome of information and cooperation. Managers can design systems and structures, as described earlier, to promote horizontal coordination and collaboration.

3.4d Geographic Structure

Another basis for structural grouping is the organization's users or customers. The most common structure in this category is geography. Each region of the country may have distinct tastes and needs. Each geographic unit includes all functions required to produce and market products or services in that region. Large nonprofit organizations such as the Girl Scouts of the USA, Habitat for Humanity, Make-A-Wish Foundation, and United Way of America frequently use a type of geographic structure, with a central headquarters and semiautonomous local units. The national organization provides brand recognition, coordinates fund-raising services, and handles some shared administrative functions, while day-to-day control and decision making is decentralized to local or regional units.[59] World Bank uses a complex type of geographic divisional structure, organized country by country and region by region. To encourage greater coordination and collaboration across regions, Jim Yong Kim, who served as World Bank president from 2012 until early 2019, implemented a sweeping reorganization that overlaid the structure with 14

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"global practices," including agriculture, energy, and education, that cut across the bank's different projects, funds, and geographies.[60]

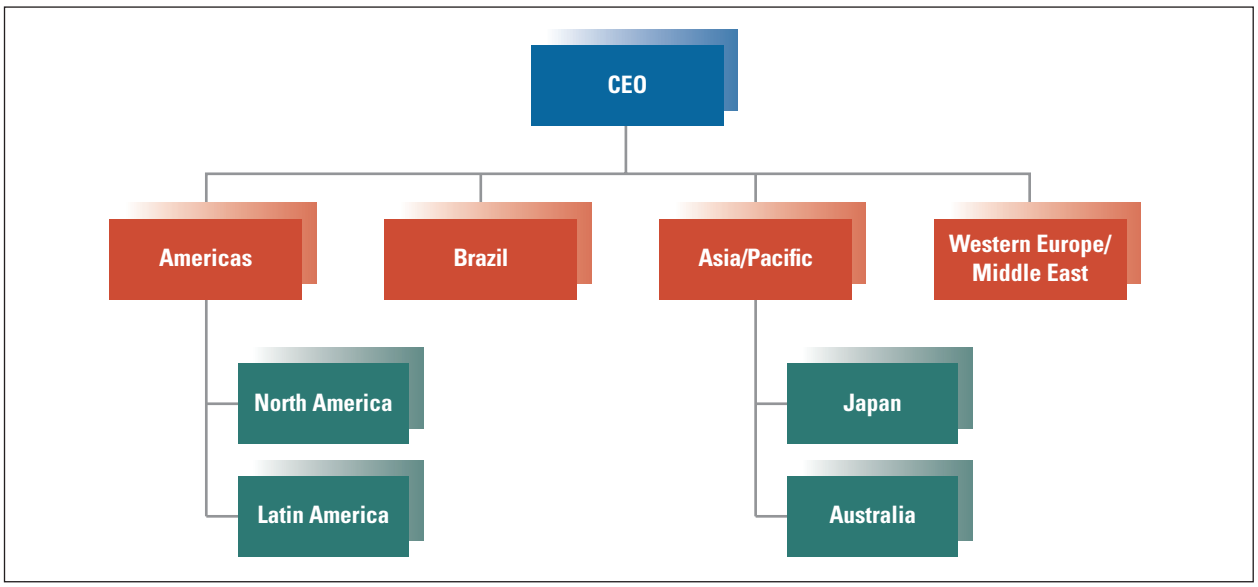
Similarly, multinational corporations may create self-contained units for different countries and parts of the world. Exhibit 3.11 shows an example of a geographic structure for a cosmetics company. This structure focuses managers and employees on specific geographic regions and sales targets. Walmart Stores are organized by geographic regions, such as Walmart Japan, Walmart India, Walmart Brazil, Walmart China, and Walmart Asia. Until recently, U.S. operations were organized largely by function, but managers restructured U.S. operations into three geographic divisions, West, South, and North, making the U.S. organization more like how Walmart operates internationally. Using a geographic structure helps the company expand into new markets and use resources more efficiently.[61]

The strengths and weaknesses of a geographic divisional structure are similar to the divisional organization characteristics listed in Exhibit 3.10. The organization can adapt to the specific needs of its own region, and employees identify with regional goals rather than with national goals. Horizontal coordination within a region is emphasized rather than linkages across regions or to the national office.

REMEMBER THIS

- Functional grouping and divisional grouping are the two most common approaches to structural design.
- Each structure has both strengths and weaknesses.
- With functional and divisional structures, managers also use horizontal linkage mechanisms to complement the vertical dimension and achieve coordination of departments and levels into an organizational whole.

EXHIBIT 3.11
Geographic Structure for Cosmetics Company



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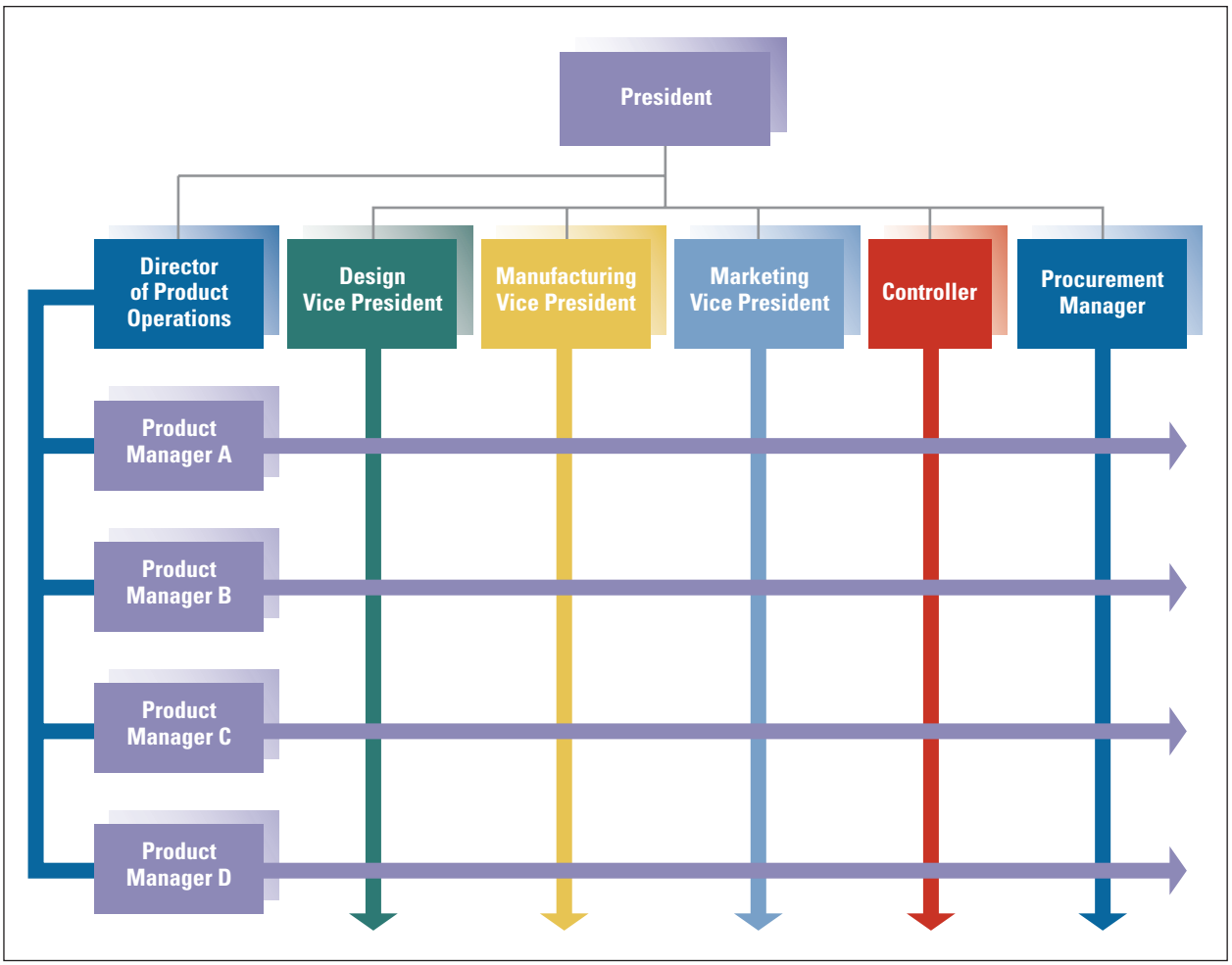
3.5 Matrix Structure

Sometimes, an organization's structure needs to be multifocused in that both product and function or product and geography are emphasized at the same time. One way to achieve this is through the **matrix structure.**[62] The matrix can be used when both technical expertise and product innovation and change are important for meeting organizational goals. The matrix structure often is the answer when organizations find that the functional, divisional, and geographic structures combined with horizontal linkage mechanisms will not work.

The matrix is a strong form of horizontal linkage. The unique characteristic of the matrix organization is that both product divisions and functional structures (horizontal and vertical) are implemented simultaneously, as shown in Exhibit 3.12. The product managers and functional managers have equal authority within the organization, and

EXHIBIT 3.12
Dual-Authority Structure in a Matrix Organization



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employees report to both of them. The matrix structure is similar to the use of full-time integrators or product managers described earlier in this chapter (Exhibit 3.4), except that in the matrix structure the product managers (horizontal) are given formal authority equal to that of the functional managers (vertical).

3.5a Conditions for the Matrix

A dual hierarchy may seem an unusual way to design an organization, but the matrix is the correct structure when the following conditions are present:[63]

- *Condition 1.* Pressure exists to share scarce resources across product lines. The organization is typically medium-sized and has a moderate number of product lines. It feels pressure for the shared and flexible use of people and equipment across those products. For example, the organization is not large enough to assign engineers full-time to each product line, so engineers are assigned part-time to several products or projects.
- *Condition 2.* Environmental pressure exists for two or more critical outputs, such as for in-depth technical knowledge (functional structure) and frequent new products (divisional structure). This dual pressure means a balance of power is needed between the functional and product sides of the organization, and a dual-authority structure is needed to maintain that balance.
- *Condition 3.* The environmental domain of the organization is both complex and uncertain. Frequent external changes and high interdependence between departments require a large amount of coordination and information processing in both vertical and horizontal directions.

Under these three conditions, the vertical and horizontal lines of authority must be given equal recognition. A dual-authority structure is thereby created so the balance of power between them is equal.

Referring again to Exhibit 3.12, assume the matrix structure is for a clothing manufacturer. Product A is footwear, product B is outerwear, product C is sleepwear, and so on. Each product line serves a different market and customers. As a medium-sized organization, the company must effectively use people from manufacturing, design, and marketing to work on each product line. There are not enough designers to warrant a separate design department for each product line, so the designers are shared across product lines. Moreover, by keeping the manufacturing, design, and marketing functions intact, employees can develop the in-depth expertise to serve all product lines efficiently.

The matrix formalizes horizontal teams along with the traditional vertical hierarchy and tries to give equal balance to both. However, the matrix may shift one way or the other. Many companies have found a balanced matrix hard to implement and maintain because one side of the authority structure often dominates. Consequently, two variations of matrix structure have evolved—the **functional matrix** and the **product matrix**. In a functional matrix, the functional bosses have primary authority and the project or product managers simply coordinate product activities. In a product matrix, by contrast, the project or product managers have primary authority and functional managers simply assign technical personnel to projects and provide advisory expertise as needed. For many organizations, one of these approaches works better than the balanced matrix with dual lines of authority.[64]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Consider a matrix structure when the organization needs to give equal priority to both products and functions because of dual pressures from customers in the environment. Use either a functional matrix or a product matrix if the balanced matrix with dual lines of authority is not appropriate for your organization.

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All kinds of organizations have experimented with the matrix, including hospitals, consulting firms, banks, insurance companies, government agencies, and many types of industrial firms.[65]

3.5b Strengths and Weaknesses

The matrix structure is best when environmental change is high and when goals reflect a dual requirement, such as for both product and functional goals. The dual-authority structure facilitates communication and coordination to cope with rapid environmental change and enables an equal balance between product and functional bosses. The matrix facilitates discussion and adaptation to unexpected problems. It tends to work best in organizations of moderate size with a few product lines. The matrix is not needed for only a single product line, and too many product lines make it difficult to coordinate both directions at once. Exhibit 3.13 summarizes the strengths and weaknesses of the matrix structure based on what we know of organizations that use it.[66]

One strength of the matrix is that it enables an organization to meet dual demands from customers in the environment. Resources (people, equipment) can be flexibly allocated across different products, and the organization can adapt to changing external requirements.[67] This structure also provides an opportunity for employees to acquire either functional or general management skills, depending on their interests.

One disadvantage of the matrix is that some employees experience dual authority, reporting to two bosses and sometimes juggling conflicting demands. This can be frustrating and confusing, especially if roles and responsibilities are not clearly defined by top managers.[68] Employees working in a matrix need excellent interpersonal and conflict-resolution skills, which may require special training in human relations. The matrix also forces managers to spend a great deal of time in meetings.[69] Many people working in matrix structures say they spend two days a week in meetings and only 50 percent of the content is relevant to them or their jobs.[70] If managers do not adapt to the information and power

EXHIBIT 3.13
Strengths and Weaknesses of Matrix Organization Structure

Strengths	Weaknesses
1. Achieves coordination necessary to meet dual demands from customers	1. Causes participants to experience dual authority, which can be frustrating and confusing
2. Flexible sharing of human resources across products	2. Means participants need good interpersonal skills and extensive training
3. Suited to complex decisions and frequent changes in unstable environment	3. Is time consuming; involves frequent meetings and conflict-resolution sessions
4. Provides opportunity for both functional and product skill development	4. Will not work unless participants understand it and adopt collegial rather than vertical-type relationships
5. Best in medium-sized organizations with multiple products	5. Requires great effort to maintain power balance

Source: Based on Robert Duncan, "What Is the Right Organization Structure? Decision Tree Analysis Provides the Answer," *Organizational Dynamics* (Winter 1979), 429; and Meenu Bhatnagar, "Managing Multiple Bosses: A New Age or HR Conundrum?" Amity Research Centers, 2018, Reference No. 418-0036-1.

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sharing required by the matrix, the system will not work. Managers must collaborate with one another rather than rely on vertical authority in decision making. The successful implementation of one matrix structure occurred at a steel company in Great Britain.

IN PRACTICE
Englander Steel

As far back as anyone could remember, the steel industry in England was stable and certain. Then in the 1990s and 2000s, excess European steel capacity, an economic downturn, the emergence of the mini mill electric arc furnace, and competition from steelmakers in Germany and Japan forever changed the steel industry.

Englander Steel employed 2,900 people, made 400,000 tons of steel a year (about one percent of Arcelor's output), and was 180 years old. For 160 of those years, a functional structure worked fine. As the environment became more turbulent and competitive, however, Englander Steel managers realized they were not keeping up. Fifty percent of Englander's orders were behind schedule. Profits were eroded by labor, material, and energy cost increases. Market share declined.

In consultation with outside experts, the president of Englander Steel saw that the company had to walk a tightrope. It had to specialize in a few high-value-added products tailored for separate markets, while maintaining economies of scale and sophisticated technology within functional departments. The dual pressure led to an unusual solution for a steel company: a matrix structure.

Englander Steel had four product lines: open-die forgings, ring-mill products, wheels and axles, and sheet steel. A business manager was given responsibility for and authority over each line and each manager had the authority needed to meet their targets and to make their lines profitable. Functional vice presidents were responsible for technical decisions. Functional managers were expected to stay abreast of the latest techniques in their areas and to keep personnel trained in new technologies that could apply to product lines. With 20,000 recipes for specialty steels and several hundred new recipes ordered each month, functional personnel had to stay current. Two functional departments—field sales and industrial relations—were not included in the matrix because they worked independently. The final design was a matrix structure with both product and functional relationships, as illustrated in Exhibit 3.14.[71]

This example illustrates the correct use of a matrix structure. The dual pressure to maintain economies of scale and to market four product lines gave equal emphasis to the functional and product hierarchies. Through continuous meetings for coordination, Englander Steel achieved both economies of scale and flexibility.

REMEMBER THIS

- The matrix structure attempts to achieve an equal balance between the vertical and horizontal dimensions of structure.
- Managers use a matrix when environmental change is high and when the organization's structure needs to be multifocused in that both product and function or product and geography are emphasized at the same time.
- One disadvantage of the matrix is a dual authority structure in which some employees report to two bosses and may have to juggle conflicting demands.

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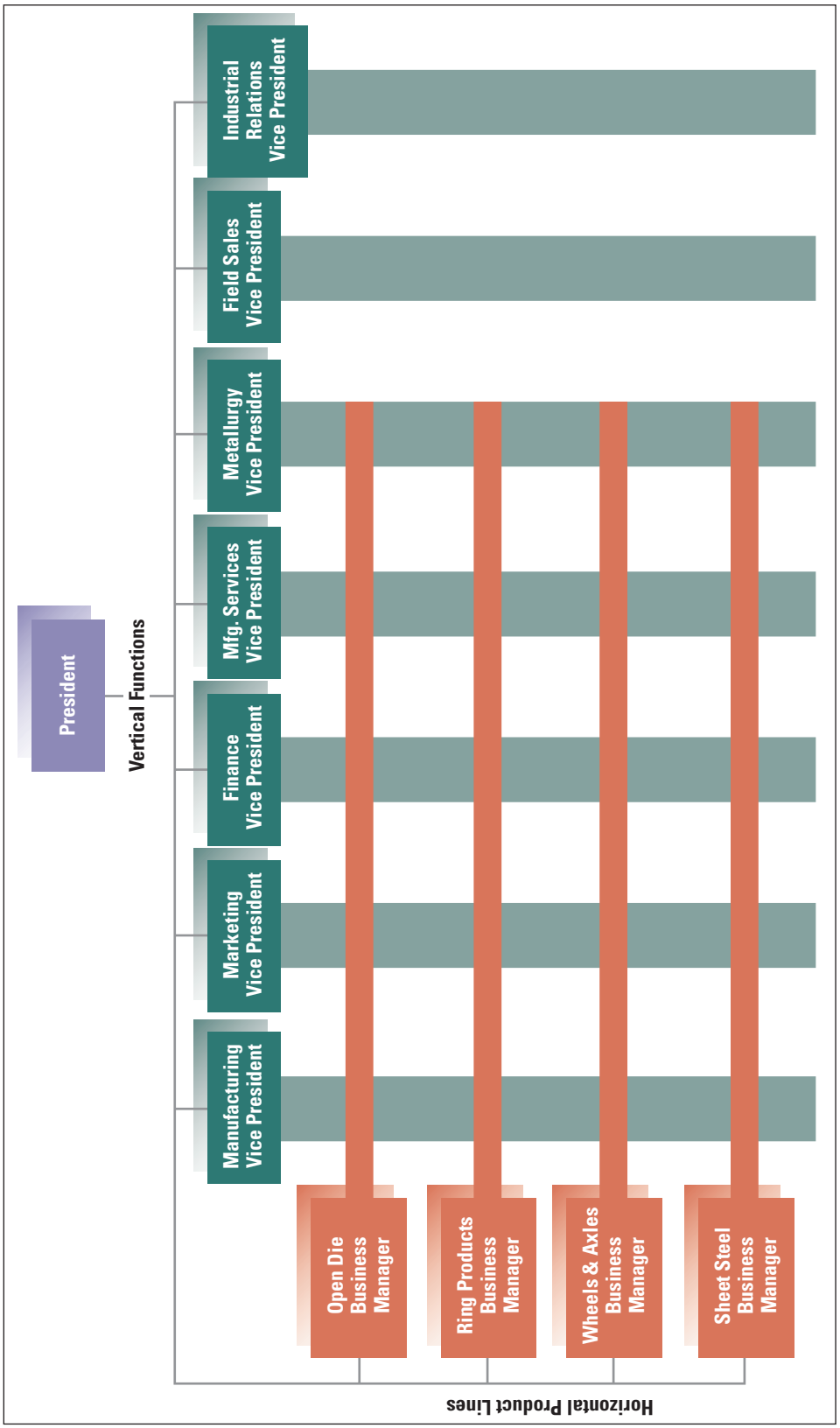

EXHIBIT 3.1.4 Matrix Structure for Englander Steel

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3.6 Virtual Network Structure and Outsourcing

A recent development in organization design extends the concept of horizontal coordination and collaboration beyond the boundaries of the traditional organization. The most widespread design trend in recent years has been the outsourcing of various parts of the organization to outside partners.[72] **Outsourcing** means to contract out certain tasks or functions, such as manufacturing, human resources, or credit processing, to other companies.

All sorts of organizations are jumping on the outsourcing bandwagon. The Ohio State University outsourced its parking system. The City of Maywood, California, decided to outsource everything from street maintenance to policing and public safety.[73] The U.S. military is also increasingly using private military company contractors to handle just about everything except the core activity of fighting battles and securing defensive positions. In the business world, Honda once designed all its new technologies in-house but turned to outsourcing due to high costs and rapid technology advancements for electric vehicles and self-driving vehicles. For example, it has a deal with Chinese start-up SenseTime Company to build camera software for self-driving vehicles, uses a semi-autonomous driving system from German supplier Bosch, and farmed out the development of an electric motor to a joint venture between Honda and Hitachi's auto parts division, in which Hitachi has the majority stake. In the 1960s, founder Soichiro Honda said, "We refuse to depend on anyone else," but the industry has changed. Today, Honda's CEO says, "We want to work with those that possess the best technology, regardless of whether they are Japanese suppliers or American ones or European ones."[74]

Once, a company's units of operation "were either within the organization and 'densely connected' or they were outside the organization and not connected at all," as one observer phrased it.[75] Today, the lines are so blurred that it can be difficult to tell what is part of the organization and what is not. IBM handles back-office operations for many large companies, but it also outsources some of its own activities to other firms, which in turn may farm out some of their functions to still other organizations.[76]

A few organizations carry outsourcing to the extreme to create a virtual network structure. With a **virtual network structure**, sometimes called a *modular structure,* the firm subcontracts most of its major functions or processes to separate companies and coordinates their activities from a small headquarters organization.[77]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Use a virtual network structure for extreme flexibility and rapid response to changing market conditions. Focus on key activities that give the organization its competitive advantage and outsource other activities to carefully selected partners.

3.6a How the Structure Works

The virtual network organization may be viewed as a central hub surrounded by a network of outside specialists. With a network structure, rather than being housed under one roof or located within one organization, services such as accounting, design, manufacturing, marketing, and distribution are outsourced to separate companies or individuals that are connected electronically to a central office. Organizational partners located in different parts of the world may use networked computers or the Internet to exchange data and information so rapidly and smoothly that a loosely connected network of suppliers, manufacturers, and distributors can look and act like one seamless company. The virtual network form incorporates a free-market style to replace the traditional vertical hierarchy. Subcontractors may flow into and out of the system as needed to meet changing needs.

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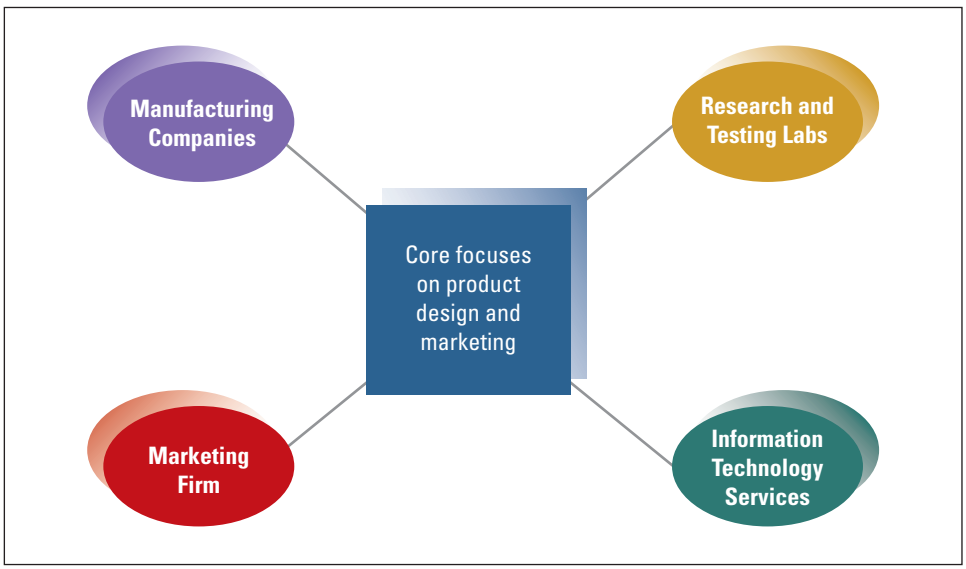
When a business chooses to use a network structure, the hub maintains control over processes in which it has world-class or difficult-to-imitate capabilities and then transfers other work activities—along with the control over them—to other organizations. These partner organizations organize and accomplish their work using their own ideas, assets, and tools.[78] The idea is that a firm can concentrate on what it does best and contract out everything else to companies with distinctive competence in those specific areas, enabling the organization to do more with less.[79] Nike was a pioneer in using the virtual network structure. Recall from the BookMark in Chapter 1 of this text that the widespread trend toward network structures has been referred to as *Nikefication*. Executives at Nike were quick to realize that design and marketing provided their company's competitive advantage, so they kept these tasks in-house and formed a network of partners to handle other functions, such as manufacturing. The company's founder, Phil Knight, came up with the idea of outsourcing manufacturing jobs to cut costs. Becoming an early adopter of the virtual organization design propelled Nike into one of the biggest athletic footwear and apparel companies in the world.[80]

With a network structure, it is difficult to answer the question "Where is the organization?" in traditional terms. The different organizational parts are drawn together contractually and coordinated electronically, creating a new form of organization. Much like building blocks, parts of the network can be added or taken away to meet changing needs.[81] Exhibit 3.15 illustrates a simplified network structure for a business such as Nike, showing some of the functions that can be outsourced to other companies.

3.6b Strengths and Weaknesses

Exhibit 3.16 summarizes the strengths and weaknesses of the virtual network structure.[82] One of the major strengths is that the organization, no matter how small, can be truly global, drawing on resources worldwide to achieve the best quality and price and then selling products or services worldwide just as

EXHIBIT 3.15
Example of a Virtual Network Structure



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Strengths	Weaknesses
1. Enables even small organizations to obtain talent and resources worldwide	1. Managers do not have hands-on control over many activities and employees
2. Gives a company immediate scale and reach without huge investments in factories, equipment, or distribution facilities	2. Requires a great deal of time to manage relationships and potential conflicts with contract partners
3. Enables the organization to be highly flexible and responsive to changing needs	3. There is a risk of organizational failure if a partner fails to deliver or goes out of business
4. Reduces administrative overhead costs	4. Employee loyalty and corporate culture might be weak because employees feel they can be replaced by contract services

EXHIBIT 3.16
Strengths and Weaknesses of Virtual Network Structure

Source: Based on R. E. Miles and C. C. Snow, "The New Network Firm: A Spherical Structure Built on a Human Investment Philosophy," *Organizational Dynamics* (Spring 1995), 5–18; Gregory G. Dess, Abdul M. A. Rasheed, Kevin J. McLaughlin, and Richard L. Priem, "The New Corporate Architecture," *Academy of Management Executive* 9, no. 3 (1995), 7–20; N. Anand and R. L. Daft, "What Is the Right Organization Design?" *Organizational Dynamics* 36, no. 4 (2007), 329–344; and H. W. Chesbrough and D. J. Teece, "Organizing for Innovation: When Is Virtual Virtuous?" *Harvard Business Review*, August 2002, 127–134.

easily through subcontractors. The network structure also enables a new or small company to develop products or services and get them to market rapidly without huge investments in factories, equipment, warehouses, or distribution facilities. The ability to arrange and rearrange resources to meet changing needs and best serve customers gives the network structure extreme flexibility and rapid response. New technologies can be developed quickly by tapping into a worldwide network of experts. The organization can continually redefine itself to meet changing technologies and shifting product or market opportunities. A final strength is reduced administrative overhead. Large teams of staff specialists and administrators are not needed. Managerial and technical talent can be focused on key activities that provide competitive advantage while other activities are outsourced.

The virtual network structure also has a number of weaknesses. The primary weakness is a lack of control. K'Nex Brands LP, a family-owned toy company near Philadelphia, brought most of the production of its plastic building toys back to its factory in the United States from subcontractors in China, for instance, to maintain greater control over quality and materials.[83] The network structure takes decentralization to the extreme. Managers do not have all operations under their jurisdiction and must rely on contracts, coordination, and negotiation to hold things together. This also means increased time spent managing relationships with partners and resolving conflicts.

3 Top managers are smart to maintain organizational control over the activities of key work units rather than contracting out some work unit tasks to other firms.

ANSWER: *Disagree.* Virtual networks and outsourcing forms of organization design have become popular because they offer increased flexibility and more rapid response in a fast-changing environment. Outsourced departments can be added or dropped as conditions change. Keeping control over all activities in-house might be more comfortable for some managers, but it discourages flexibility.

ASSESS YOUR ANSWER

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A problem of equal importance is the risk of failure if one organizational partner fails to deliver, has a plant burn down, or goes out of business. Managers in the headquarters organization have to act quickly to spot problems and find new arrangements. Finally, from a human resource perspective, employee loyalty can be weak in a network organization because of concerns over job security. Employees may feel that they can be replaced by contract services. In addition, it is more difficult to develop a cohesive corporate culture. Turnover may be higher because emotional commitment between the organization and employees is low. With changing products, markets, and partners, the organization may need to reshuffle employees at any time to get the correct mix of skills and capabilities.

REMEMBER THIS

- A virtual network structure extends the concept of horizontal coordination and collaboration beyond the boundaries of the organization.
- Activities that provide the organization's competitive advantage are kept in-house, while other functions and activities are outsourced to contract partners.
- Using a virtual network structure enables a company to move quickly to address changing technologies, products, and markets.
- The widespread trend toward network structures has been referred to as Nikefication because Nike was one of the first major companies to use this design.

3.7 Holacracy Team Structure

The most recent approach to organization design involves a shift toward self-management. One extreme self-management model is called a holacracy or **holacracy team structure**. The design trend toward self-management reflects a fundamental mind-shift in the way human organizations and management are viewed. Self-management goes beyond contemporary ideas such as employee empowerment, flatter organizations, distributed decision making, elimination of bureaucratic red tape, and pushing authority lower in the hierarchy. Complete self-management includes all these ideas, and even more. The traditional management functions of planning, organizing, staffing, and controlling are assigned to all employees. There are no managers to perform these management functions. All organization members are personally responsible for planning their own work, coordinating their actions with others, developing their own personal relationships, acquiring needed resources, and taking corrective action with respect to other members as needed.[84]

Companies such as Morning Star, Valve, W. L. Gore, and Zappos have adopted some form of extreme self-management. Morning Star emphasizes a few key ideas as the basis for its self-management philosophy:[85]

- People are generally happier when they have control over their own life and work.

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- It does not make sense to give decision-making authority to the person furthest away from the actual work.
- The traditional hierarchical model is a recipe for a slow painful death.
- There is an undeniable link between freedom and economic prosperity.

The most widely used model of self-management, the holacracy team structure, has been adopted in about 300 organizations. In this organizational design, circles (the holacracy term for teams) are the basic unit and building block of structure, not individuals, departments, or divisions. Each circle shares a common purpose and has decision-making authority over how to do its work and achieve its purpose. For example, there might be a circle for helping to hire new employees or a circle charged with motivating employee professional growth and recognizing employee achievements. Sub-circles can be created for tasks that do not require input from all team members. Members may choose to change circles to follow their specific passions. The holacracy team structure is an extreme organic design composed of fluid teams and no managers. A few informal leaders may emerge within the circles based on who has expertise in the matter at hand. Employees decide when a new circle is needed or when a circle should be abandoned.[86]

Within each circle, individual roles are jointly negotiated with other members regarding the tasks needed to accomplish the circle's purpose. People do not have "job descriptions." Each individual has authority over how individual goals are achieved, discretion over resource use, ownership of knowledge related to the work, and accountability for work outcomes. In a holacracy team structure, each individual performs a variety of roles and probably has a role on three to four teams at the same time. The same individual might serve as a design technologist on one team, act as finance advisor on another team, and perform as a meeting facilitator on a third team. The key is that employees discuss their own role with other circle members to define role boundaries and stay coordinated with one another and aligned with each circle's purpose. Employees are encouraged to make decisions at the point of origin. Conflicts are addressed face-to-face without a manager. If there is no resolution, the participants can appeal to a peer council.[87]

Autonomous self-managed team designs such as the holacracy team structure typically start with a written guideline. The circles are nested within a larger structure that individuals can help define. In a holacracy, employees ratify the constitution outlining the rules by which circles are created, changed, or removed. The constitution does not tell people how to do their jobs. It is a broad-brush document describing how circles can form, operate, and govern themselves. The guide describes how to identify and assign roles, the boundaries the roles should have, and how circles interact with each other.[88] At Morning Star, each employee consults with coworkers and writes up a formal agreement known internally as a "colleague letter of understanding." Each employee talks with coworkers to develop an understanding of what is needed. These letters outline jointly agreed upon responsibilities, goals, activities, and metrics for evaluating performance to spell out an employee's work commitments.[89]

This structure is used primarily in small to medium size organizations that face a need for continuous learning and innovation to meet rapidly changing customer needs. One of the largest and most well-known companies using a holacracy team structure is online retailer Zappos.

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IN PRACTICE

Zappos

When Zappos shifted to a holacracy team structure, 150 departments disappeared and were replaced by around 500 self-managed circles and sub-circles that were designed around projects and tasks rather than hierarchy and job descriptions. Job titles were a thing of the past. There were no bosses. People would now perform multiple roles in a variety of ever-shifting teams. The "people managing" responsibilities previously held by managers would be split among three team roles—"lead links," who would focus on guiding the specific work; "mentors," who would focus on employee growth and development; and "compensation appraisers," who would concentrate on employees' salaries. No one was assigned to these—or any other—roles. Rather, people would negotiate with one another and allocate duties to those who were best suited to performing them. Employees would move into and out of roles—just as they would move into and out of various circles—as needed to address perceived changes in ongoing needs.

CEO Tony Hsieh had originally planned to shift Zappos to holacracy over a three-year period, but about mid-way through the process, he decided that a more radical approach was needed. He sent employees a memo stating the date when the change to holacracy would occur. Hsieh offered three months' severance pay to anyone who felt that he or she just wasn't interested in working in the new type of organization design. About 200 people took him up on the offer. Those who stayed have been working within and adapting the new structure since 2015.[90]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Consider a holacracy team structure when customer needs and demands change rapidly and when learning and innovation are critical to organizational success. Train managers and employees in the social and team skills to work effectively in a holacracy team structure.

3.7a Characteristics

An illustration of a holacracy team structure appears in Exhibit 3.17. Such an organization has the following characteristics:[91]

- Teams (circles), rather than individuals, tasks, departments, or other units, are the fundamental building blocks of the organization. Everyone works on a team in a holacracy.
- Individual roles are collectively defined and assigned within the various teams as needed to accomplish the work.
- Teams evolve, form, and disband as conditions change. As new opportunities, needs, problems, goals, and tasks emerge, organizational members create new teams or circles to address them. One example comes from KETC, the public television station in St. Louis, which forms temporary teams to bring community ideas into its programming surrounding major local or national events.[92]
- Teams design and govern themselves. Holacracy teams work inside a larger structure of circles that everyone has a hand in shaping. In a holacracy, people generate and agree to a governing constitution that defines the rules by which teams operate, such as the way they should form, how they identify and assign roles, and how members should interact among themselves and with other teams.
- Leadership is distributed and contextual. No one is an assigned "manager." The responsibilities of leadership are continually shifting as needs arise, teams change, and new roles are defined.

3.7b Strengths and Weaknesses

As with all structures, the holacracy team structure has both strengths and weaknesses, as listed in Exhibit 3.18.

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EXHIBIT 3.17
A Holacracy Team Structure

Source: Based on Jacob Morgan, "The 5 Types of Organizational Structures: Part 5, Holacratic Organizations," *Forbes*, July 20, 2015, https://www.forbes.com/sites/jacobmorgan/2015/07/20/the-5-types-of-organizational-structures-part-5-holacratic-organizations/#70578f1848a2 (accessed April 4, 2019).

Strengths	Weaknesses
1. Promotes a focus on teamwork and collaboration	1. Determining individual and team responsibilities is time consuming
2. Promotes rapid, innovative responses to customer needs	2. Requires changes in management philosophy and culture
3. Each employee has a broader view of the organization's purpose	3. Traditional managers may baulk when they have to give up power and authority
4. Decisions are made close to the work	4. Requires significant training of employees in social skills
5. Improves employee growth via sharing responsibility, making decisions, and being accountable for outcomes	5. Can limit in-depth skill development in a specific function

EXHIBIT 3.18
Strengths and Weaknesses of Holacracy Team Structure

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The most significant strength of the holacracy team structure is enhanced coordination, which can dramatically increase the company's flexibility and innovative response to shifts in customer needs. For example, Valve made the decision to expand from PC games to hardware because a few employees grew tired of repeated customer requests for hardware that enabled people to play games in their living room. People formed a team to investigate the ideas that resulted in a huge new hardware release.[93]

In addition, because there are no boundaries between functional departments, employees take a broader view of organizational goals rather than being focused on the goals of a single department. The holacracy team structure promotes an emphasis on teamwork and cooperation so that team members share a commitment to meeting common objectives. Moreover, decisions are made close to the work which avoids the web of hierarchical titles and reporting relationship that make it hard to figure out who decides, requires written justification, and slows everything down, and the decision-maker does not understand the problem. Finally, the holacracy structure can improve the quality of life and personal growth for employees by giving them opportunities to share responsibility, make decisions, and contribute significantly to the organization. Employees are typically enthusiastic about their involvement in bigger projects rather than narrow departmental tasks.

One weakness of the holacracy team structure is that it can be complicated and time-consuming to set up in an existing company because it requires significant changes in culture, job design, management philosophy, and information and reward systems. Traditional managers may baulk when they have to give up power and authority to serve instead as members of various teams. Employees have to be trained with the social skills to work effectively in a team environment. Finally, the team structure can limit in-depth knowledge and skill development in technical areas that could be attained in a functional structure.

REMEMBER THIS

- The most recent approach to organization design involves a shift toward self-management.
- The most widely used model of self-management is the holacracy team structure, which has been adopted in about 300 organizations. In a holacracy, everyone works on a circle (team) and there are no bosses.
- Each circle shares a common purpose and has decision-making authority over how to do its work and achieve its purpose.
- Individual roles are collectively defined and assigned within the various circles, and circles evolve, form, and disband as conditions change.
- Each person performs a variety of roles and may have a role on three or four teams at the same time.
- One of the most well-known companies using a holacracy team structure is Zappos.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Mix and match characteristics of functional, divisional, and holacracy team structures in complex environments to take advantage of the strengths of various structural characteristics and avoid some of the weaknesses.

3.8 Applications of Structural Design

Each type of structure is applied in different situations and meets different needs. In describing the various structures, we touched briefly on conditions such as environmental stability or change and organizational size that are related to structure.

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Each form of structure—functional, divisional, matrix, network, and holacracy team—represents a tool that can help managers make an organization more effective, depending on the demands of its situation.

3.8a Mix and Match

As a practical matter, many structures in the real world do not exist in the pure forms we have outlined in this chapter.[94] Most large organizations, in particular, often combine characteristics of various approaches tailored to different parts of the organization. By mixing characteristics of functional, divisional, geographic, virtual network, or holacracy team structures, managers can take advantage of the strengths of various structures and avoid some of the weaknesses. Mixing structural characteristics offers the organization greater flexibility in a shifting environment.

One approach that is often used is to combine characteristics of the functional and divisional structures. When a corporation grows large and has several products or markets, it typically is organized into self-contained divisions of some type. Functions that are important to each division are decentralized to the self-contained units. However, some functions that are relatively stable and require economies of scale and in-depth specialization are centralized at headquarters. For example, Starbucks has a number of geographic divisions, but functions such as marketing, legal, and supply chain operations are centralized.[95] In a huge organization such as General Electric, Walmart, or Ford Motor Company, managers may use a variety of structural characteristics to meet the needs of the total organization.

3.8b Structural Alignment

Ultimately, the most important decision that managers make about structural design is to find the right balance between vertical control and horizontal coordination, depending on the needs of the organization. Vertical control is associated with goals of efficiency and stability, while horizontal coordination is associated with learning, innovation, and flexibility. Exhibit 3.19 shows a simplified continuum that illustrates how structural approaches are associated with vertical control versus horizontal coordination. The functional structure is appropriate when the organization needs to be coordinated through the vertical hierarchy and when efficiency is important for meeting organizational goals. The functional structure uses task specialization and a strict chain of command to gain efficient use of scarce resources, but it does not enable the organization to be flexible or innovative. At the opposite end of the scale, the holacracy team structure is appropriate when the organization has a high need for coordination among functions to achieve innovation and promote learning. The holacracy team structure enables organizations to differentiate themselves and respond quickly to changes, but at the expense of efficient resource use. Exhibit 3.19 also shows how other types of structure defined in this chapter—functional with horizontal linkages, divisional, matrix, and virtual network—represent intermediate steps on the organization's path to efficiency or innovation and learning. The exhibit does not include all possible structures, but it illustrates how organizations attempt to balance the needs for efficiency and vertical control with innovation and horizontal coordination. In addition, as described in the chapter, many organizations combine characteristics of various structural types.

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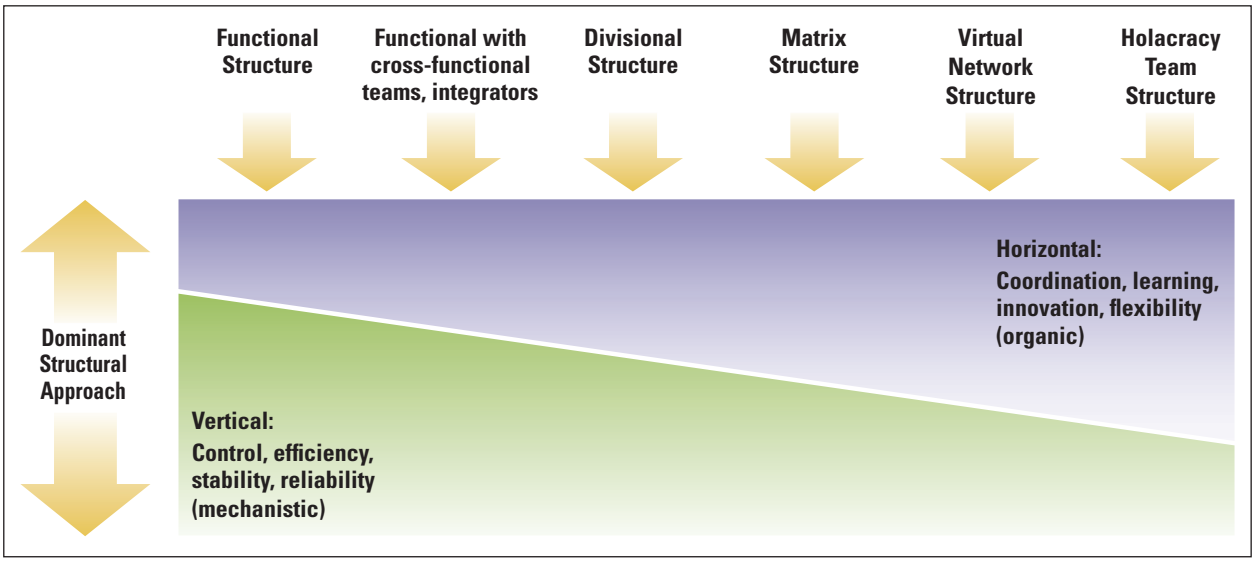
EXHIBIT 3.19
Relationship of Structure to Organization's Need for Efficiency Versus Learning



BRIEFCASE

As an organization manager, keep these guidelines in mind:

Find the correct balance between vertical control and horizontal coordination to meet the needs of the organization. Consider a structural reorganization when symptoms of structural deficiency are observed.

3.8c Symptoms of Structural Deficiency

Top executives periodically evaluate organization structure to determine whether it is appropriate to changing needs. Managers try to achieve the best fit between internal reporting relationships and the needs of the external environment. As a general rule, when organization structure is out of alignment with organization needs, one or more of the following **symptoms of structural deficiency** appear.[96]

- *There is an absence of collaboration among units.* Organization structure should encourage collaboration when and where it is needed to meet organizational goals. It should enable resolution of conflicting departmental needs and goals into a single set of goals for the entire organization. When departments act at cross-purposes or are under pressure to achieve departmental goals at the expense of organizational goals, the structure is often at fault. Horizontal linkage mechanisms are not adequate.
- *Decision making is delayed or lacking in quality.* Decision makers may be overloaded because the hierarchy funnels too many problems and decisions to them. Delegation to lower levels may be insufficient. Another cause of poor-quality decisions is that information may not reach the correct people. Information linkages in either the vertical or horizontal direction may be inadequate to ensure decision quality.
- *The organization does not respond innovatively to a changing environment.* One reason for lack of innovation is that departments are not coordinated horizontally. The identification of customer needs by the marketing department and the identification of technological developments in the research department must be coordinated. Organization structure also has to specify departmental responsibilities that include environmental scanning and innovation.

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- *Employee performance declines and goals are not being met.* Employee performance may decline because the structure doesn't provide clear goals, responsibilities, and mechanisms for coordination and collaboration. The structure should reflect the complexity of the market environment yet be straightforward enough for employees to effectively work within.

REMEMBER THIS

- In many companies, top executives combine characteristics of various structural approaches tailored to specific needs. Mixing structural characteristics enables the organization to take advantage of the strengths of various structures and avoid some of the weaknesses.
- Ultimately, managers attempt to find the correct balance between vertical control and horizontal coordination.
- Signs of structural misalignment include lack of collaboration, delayed decision making, lack of innovation, and poor employee performance.
- Finally, an organization chart is only so many lines and boxes on a piece of paper. The organization chart provides the structure, but employees provide the behavior. The chart is a guideline to encourage people to work together, but management must implement the structure and carry it out.

KEY CONCEPTS

centralization
collaboration
cross-functional teams
decentralization
departmental grouping
divisional grouping
divisional structure
functional grouping
functional matrix
functional structure
holacracy team grouping
holacracy team structure
horizontal linkage
integrator
liaison role
matrix structure
multifocused grouping
organization structure
outsourcing
product matrix
relational coordination
symptoms of structural deficiency
task force
vertical information system
vertical linkages
virtual network grouping
virtual network structure
virtual team

DISCUSSION QUESTIONS

1. To what extent does the true structure of an organization appear on the organization chart? Explain.
2. When is a functional structure preferable to a divisional structure?
3. Large corporations tend to use different structures in different parts of the organization. Why would that be so?
4. What are the primary differences in structure between a traditional, mechanistic organization designed for efficiency and a more flexible organic organization designed for learning?
5. What is the difference between a task force and a team? Between liaison role and integrating role? Which of these provides the greatest amount of horizontal coordination?
6. As a manager, how would you create an organization with a high degree of relational coordination?
7. Why do you think the pressure of scarce resources across product lines causes managers to consider a matrix structure?
8. The manager of a consumer products firm said, "We use the brand manager position to train future executives." Why do you think the brand manager position is considered a good training ground? Discuss.

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9. Why do companies using a holacracy team structure have cultures that emphasize openness, employee empowerment, and responsibility? What do you think it would be like to work in a company with such a structure?
10. Describe the virtual network structure. What are the advantages and disadvantages of using this structure compared to performing all activities in-house within an organization?

CHAPTER 3 WORKBOOK You and Organization Structure[97]

To better understand the importance of organization structure in your life, do the following assignment.

Work with a partner or a small team to select one of the following situations to organize and to complete this exercise:

- A copy and print shop
- A travel agency
- A sports rental (such as Jet Skis or snowmobiles) in a resort area
- A bakery

Background

Organization is a way of gaining some internal efficiency and some power against random forces in the environment. The environment provides the organization with inputs, which include raw materials, human resources, and financial resources. There is a service or product to produce that involves technology. The output goes to clients, a group that must be nurtured. The complexities of the environment and the technology determine the complexity of the organization.

Planning Your Organization

1. Write down the mission or purpose of the chosen organization in a few sentences.
2. What are the specific tasks to be completed to accomplish the mission?
3. Based on the specifics in question 2, develop an organization chart. Each position in the chart will perform a specific task or is responsible for a certain outcome.
4. You are into your third year of operation, and your business has been very successful. You want to add a second location a few miles away. What issues will you face running the business at two locations? Draw an organization chart that includes the two business locations.
5. Twenty years later you have 75 business locations in five states. What are the issues and problems that have to be dealt with through organizational structure? Draw an organization chart for this organization, indicating such factors as who is responsible for customer satisfaction, how you will know if customer needs are met, and how information will flow within the organization.

CASE FOR ANALYSIS | Holtzclaw Supermarkets, Inc.[98]

The first Holtzclaw Supermarkets store was started in 1977 by Sam Holtzclaw and his brother Bob. Both were veterans who wanted to run their own business, so they used their savings to start the small grocery store in Charlotte, North Carolina. The store was immediately successful. The location was good, and Sam Holtzclaw had a winning personality. Store employees adopted Sam's informal style and "serve the customer" attitude. Holtzclaw's increasing circle of customers enjoyed an abundance of good meats and produce.

By 2001, Holtzclaw had over 200 stores. A standard physical layout was used for new stores. Company headquarters moved from Charlotte to Atlanta in 1995. The organization chart for Holtzclaw Supermarkets is shown in Exhibit 3.20. The central offices in Atlanta handled human resources, merchandising, financial, purchasing, real estate, and legal affairs for the entire chain. For management of individual stores, the organization was divided by regions. The southern, southeastern, and southwestern regions each had about 70 stores. Each region was divided into five districts of 10 to 15 stores each. A district director was responsible for supervision and coordination of activities for the 10 to 15 district stores.

Each district was divided into four lines of authority based on functional specialty. Three of these lines reached into the stores. The produce department manager within each store reported directly to the produce specialist for the division, and the same was true for the meat department manager, who reported directly to the district meat specialist. The meat and produce managers were responsible for all activities associated with the acquisition and sale of perishable products. The store manager's responsibility included the grocery line, front-end departments, and store operations. The store manager was responsible for appearance of personnel, cleanliness, adequate checkout service, and price accuracy. A grocery manager reported to the store manager, maintained inventories, and restocked shelves for grocery items. The district merchandising office was responsible for

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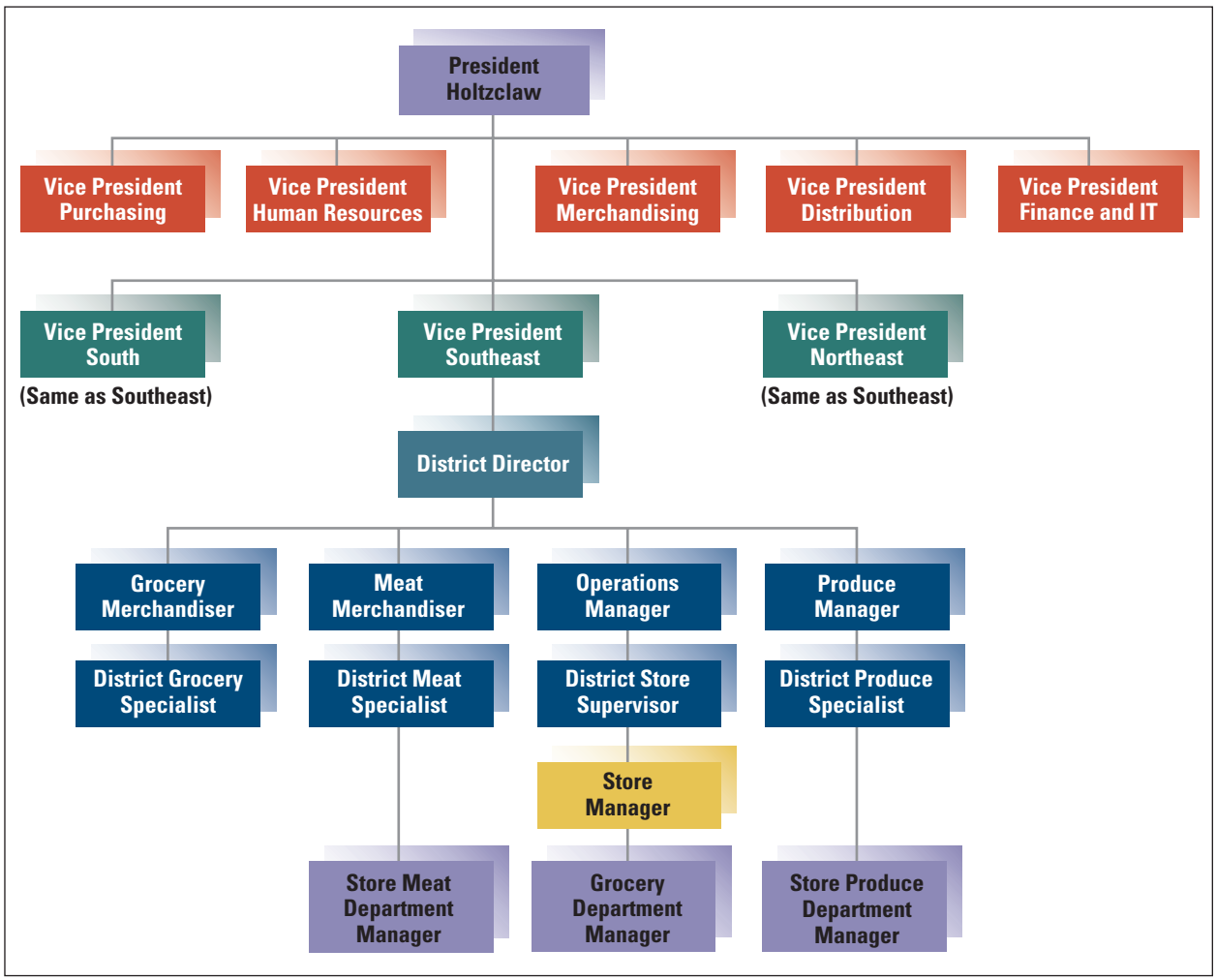
promotional campaigns, advertising circulars, district advertising, and attracting customers into the stores. The grocery merchandisers were expected to coordinate their activities with each store in the district.

Business for the Holtzclaw chain has dropped off in all regions in recent years—mostly because of increased competition from large discount retailers such as Walmart, Target, and Costco. When these large discounters entered the grocery business, they brought a level of competition unlike any the Holtzclaw brothers had seen before. Holtzclaw had managed to hold its own against larger supermarket chains, but now even the big chains were threatened by Walmart, which became number one in grocery sales in 2001. Holtzclaw managers knew they couldn't compete on price, but they were considering ways they could use advanced information technology to improve service and customer satisfaction and distinguish the store from the large discounters.

However, the most pressing problem was how to improve business with the resources and stores they now had. A consulting team from a major university was hired to investigate store structure and operations. The consultants visited several stores in each region, talking to about 50 managers and employees. The consultants wrote a report that pinpointed four problem areas to be addressed by store executives.

1. *The chain was slow to adapt to change.* Store layout and structure were the same as had been designed 15 years ago. Each store did things the same way, even though some stores were in low-income areas and other stores in suburban areas. A new computerized supply chain management system for ordering and stocking had been developed, but after two years it was only partially implemented in the stores. Other proposed information technology (IT) initiatives were still "on the back burner," not yet even in the development stage.

EXHIBIT 3.20
Organization Structure for Holtzclaw Supermarkets, Inc.



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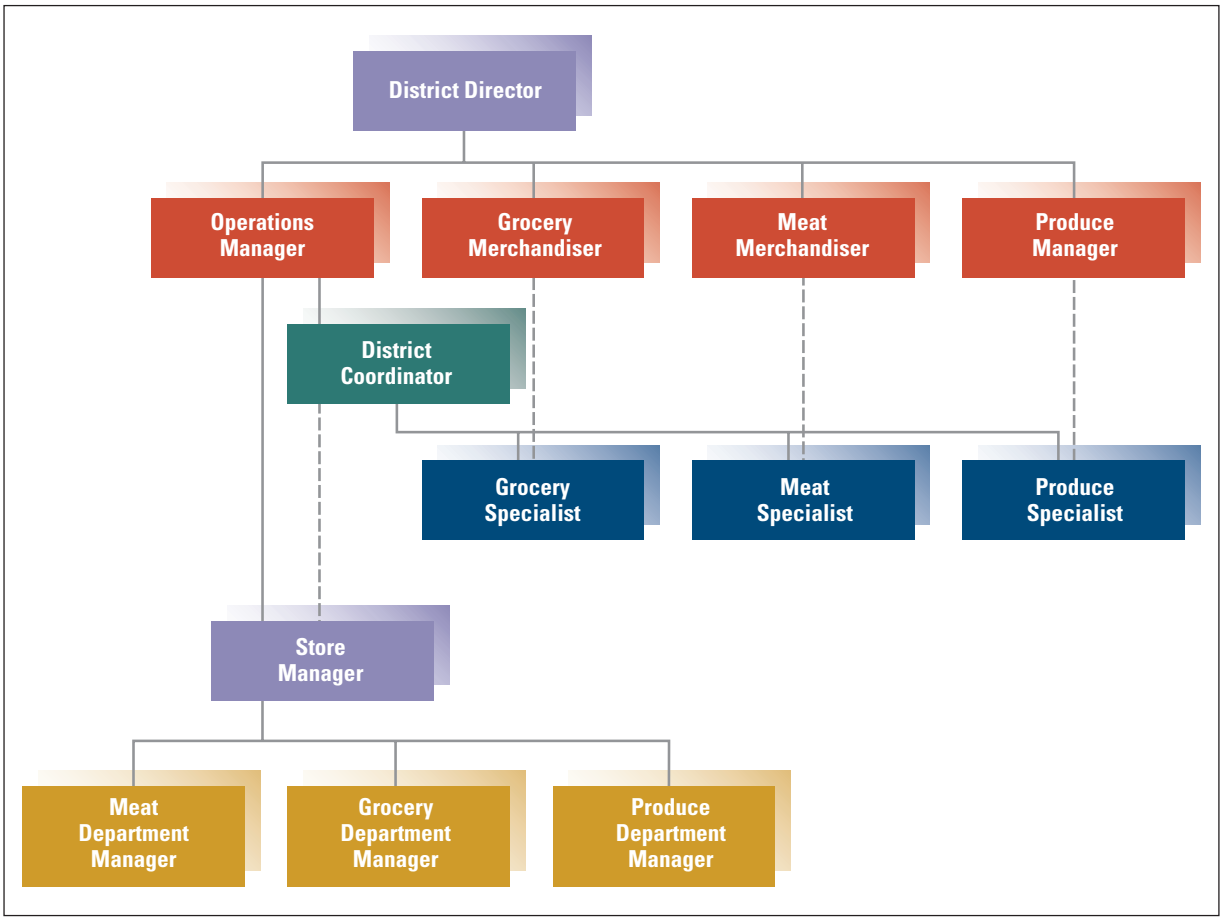
2. *Roles of the district store supervisor and the store manager were causing dissatisfaction.* Store managers wanted more decentralization and freedom to tailor store inventory, and to carry specialty products, to fit their specific market clientele as a way to boost sales. The store managers also wanted to learn general management skills for potential promotion into district or regional management positions. However, their jobs restricted them to narrow operational activities with little authority and they learned little about merchandising, meat, and produce. Moreover, district store supervisors used store visits to inspect for cleanliness and adherence to operating standards rather than to train the store manager and help coordinate operations with perishable departments. Close supervision on the operational details had become the focus of operations management rather than development, training, and coordination.
3. *Cooperation within stores was low and morale was poor. The informal, friendly atmosphere originally created by Sam Holtzclaw was gone.* One example of this problem occurred when the grocery merchandiser and store manager in a Louisiana store decided to promote Coke and Diet Coke as a loss leader. Thousands of cartons of Coke were brought in for the sale, but the stockroom was not prepared and did not have room. The store manager wanted to use floor area in the meat and produce sections to display Coke cartons, but those managers refused. The produce department manager said that Diet Coke did not help his sales and it was okay with him if there was no promotion at all.
4. *Long-term growth and development of the store chain would probably require re-evaluation of long-term strategy.* The percent of market share going to traditional grocery stores was declining nationwide due to competition from large superstores and discount retailers. In the near future, Holtzclaw might need to introduce nonfood items into the stores for one-stop shopping, add specialty or gourmet sections within stores, and investigate how new technology could help distinguish the company, such as through targeted marketing or online promotions via Facebook

EXHIBIT 3.21
Proposed Reorganization of Holtzclaw Supermarkets, Inc.



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or Google, providing superior service and convenience, and offering their customers the best product assortment and availability.

To solve the first three problems, the consultants recommended reorganizing the district and the store structure as illustrated in Exhibit 3.21. Under this reorganization, the meat, grocery, and produce department managers would all report to the store manager. The store manager would have complete store control and would be responsible for coordination of all store activities. The district supervisor's role would be changed from supervision to training and development. The district supervisor would head a team that included himself and several meat, produce, and merchandise specialists who would visit area stores as a team to provide advice and help for the store managers and other employees. The team would act in a liaison capacity between district specialists and the stores.

The consultants were enthusiastic about the proposed structure. With the removal of one level of district operational supervision, store managers would have more freedom and responsibility. The district liaison team would establish a cooperative team approach to management that could be adopted within stores. Focusing store responsibility on a single manager would encourage coordination within stores and adaptation to local conditions. It would also provide a focus of responsibility for storewide administrative changes.

The consultants also believed that the proposed structure could be expanded to accommodate nongrocery lines and gourmet units if these were included in Holtzclaw's future plans. Within each store, a new department manager could be added for pharmacy, gourmet/specialty items, an on-site bakery, or other major departments. The district team could be expanded to include specialists in these lines, as well as an information technology coordinator to act as liaison for stores in the district.

Questions

1. In general, how did Holtzclaw's first organization structure contribute to the dissatisfaction of store managers, poor coordination, and Holtzclaw's slow adaptation to change?
2. How would the proposed reorganization address the problems in question 1?
3. What disadvantages might emerge over time with the proposed reorganization?

CASE FOR ANALYSIS | Aquarius Advertising Agency[99]

The Aquarius Advertising Agency is a medium-sized firm that offered two basic services to its clients: customized plans for the content of an advertising campaign (e.g., slogans and layouts) and complete plans for media (e.g., radio, TV, newspapers, billboards, and Internet). Additional services included aid in marketing and distribution of products and marketing research to test advertising effectiveness.

Its activities were organized in a traditional manner. The organization chart is shown in Exhibit 3.22. Each department included similar functions.

Each client account was coordinated by an account executive who acted as a liaison between the client and the various specialists on the professional staff of the operations and marketing divisions. The number of direct communications and contacts between clients and Aquarius specialists, clients and account executives, and Aquarius specialists and account executives is indicated in Exhibit 3.23. These sociometric data were gathered by a consultant who conducted a study of the patterns of formal and informal communication. Each intersecting cell of Aquarius personnel and the clients contains an index of the direct contacts between them.

Although an account executive was designated to be the liaison between the client and specialists within the agency, communications frequently occurred directly between clients and specialists and bypassed the account executive. These direct contacts involved a wide range of interactions, such as meetings, telephone calls, and e-mail messages. A large number of direct communications occurred between agency specialists and their counterparts in the client organization. For example, an art specialist working as one member of a team on a particular client account would often be contacted directly by the client's in-house art specialist, and agency research personnel had direct communication with research personnel of the client firm. Also, some of the unstructured contacts often led to more formal meetings with clients in which agency personnel made presentations, interpreted and defended agency policy, and committed the agency to certain courses of action.

Both hierarchical and professional systems operated within the departments of the operations and marketing divisions. Each department was organized hierarchically with a director, an assistant director, and several levels of authority. Professional communications were widespread and mainly concerned with sharing knowledge and techniques, technical evaluation of work, and development of professional interests. Control in each department was exercised mainly through control of promotions and supervision of work done by subordinates. Many account executives, however, felt the need for more influence, and one commented:

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EXHIBIT 3.22
Aquarius Advertising Agency Organization Chart

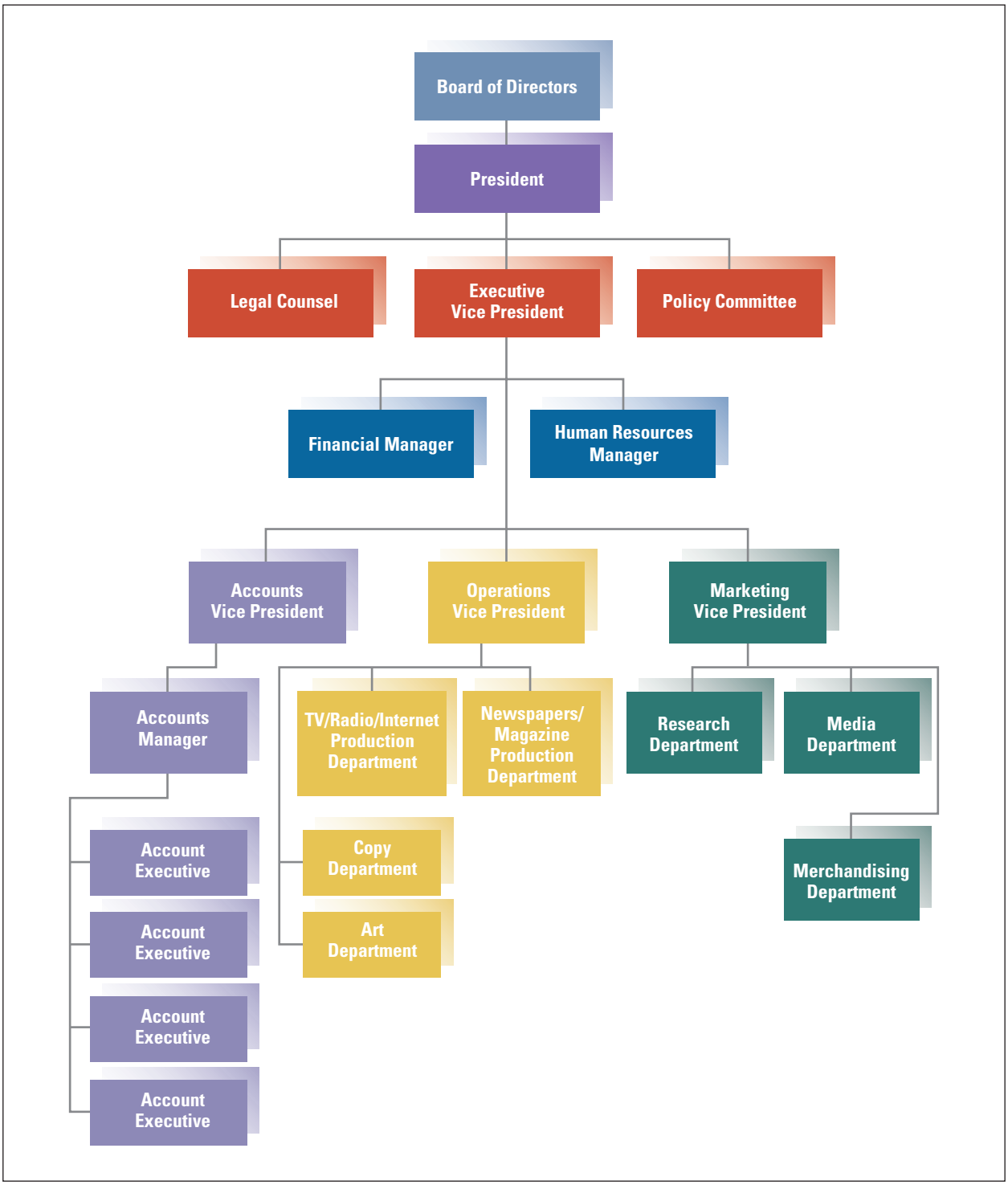

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EXHIBIT 3.23

Sociometric Index of Aquarius Personnel and Clients
F = Frequent—daily
O = Occasional—once or twice per project
N = None

	Clients	Account Manager	Account Executives	TV/Radio Specialists	Newspaper/Magazine Specialists	Copy Specialists	Art Specialists	Merchandising Specialists	Media Specialists	Research Specialists
Clients	X	F	F	N	N	O	O	O	O	O
Account Manager		X	F	N	N	N	N	N	N	N
Account Executives			X	F	F	F	F	F	F	F
TV/Radio Specialists				X	N	O	O	N	N	O
Newspaper/Magazine Specialists					X	O	O	N	O	O
Copy Specialists						X	N	O	O	O
Art Specialists							X	O	O	O
Merchandising Specialists								X	F	F
Media Specialists									X	F
Research Specialists										X

Creativity and art. That's all I hear around here. It is hard as hell to effectively manage six or seven hotshots who claim they have to do their own thing. Each of them tries to sell his or her idea to the client, and most of the time I don't know what has happened until a week later. If I were a despot, I would make all of them check with me first to get approval. Things would sure change around here.

The need for reorganization was made more acute by changes in the environment. Within a short period of time, there was a rapid turnover in the major accounts handled by the agency. It was typical for advertising agencies to gain or lose clients quickly, often with no advance warning as consumer behavior and lifestyle changes emerged and product innovations occurred.

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An agency reorganization was one solution proposed by top management to increase flexibility in this unpredictable environment. The reorganization would be aimed at reducing the agency's response time to environmental changes and at increasing cooperation and communication among specialists from different departments. The top managers are not sure what type of reorganization is appropriate. They would like your help analyzing their context and current structure and welcome your advice on proposing a new structure.

Questions

1. Analyze Aquarius with respect to the five contextual variables described in Chapter 1. Which of the five contextual variables would you say is having the greatest impact on Aquarius?
2. Design a new organization structure that takes into consideration the information flows in Exhibit 3.23 as well as the most significant contextual variable.
3. Would a matrix structure be feasible for Aquarius? What is your evidence?

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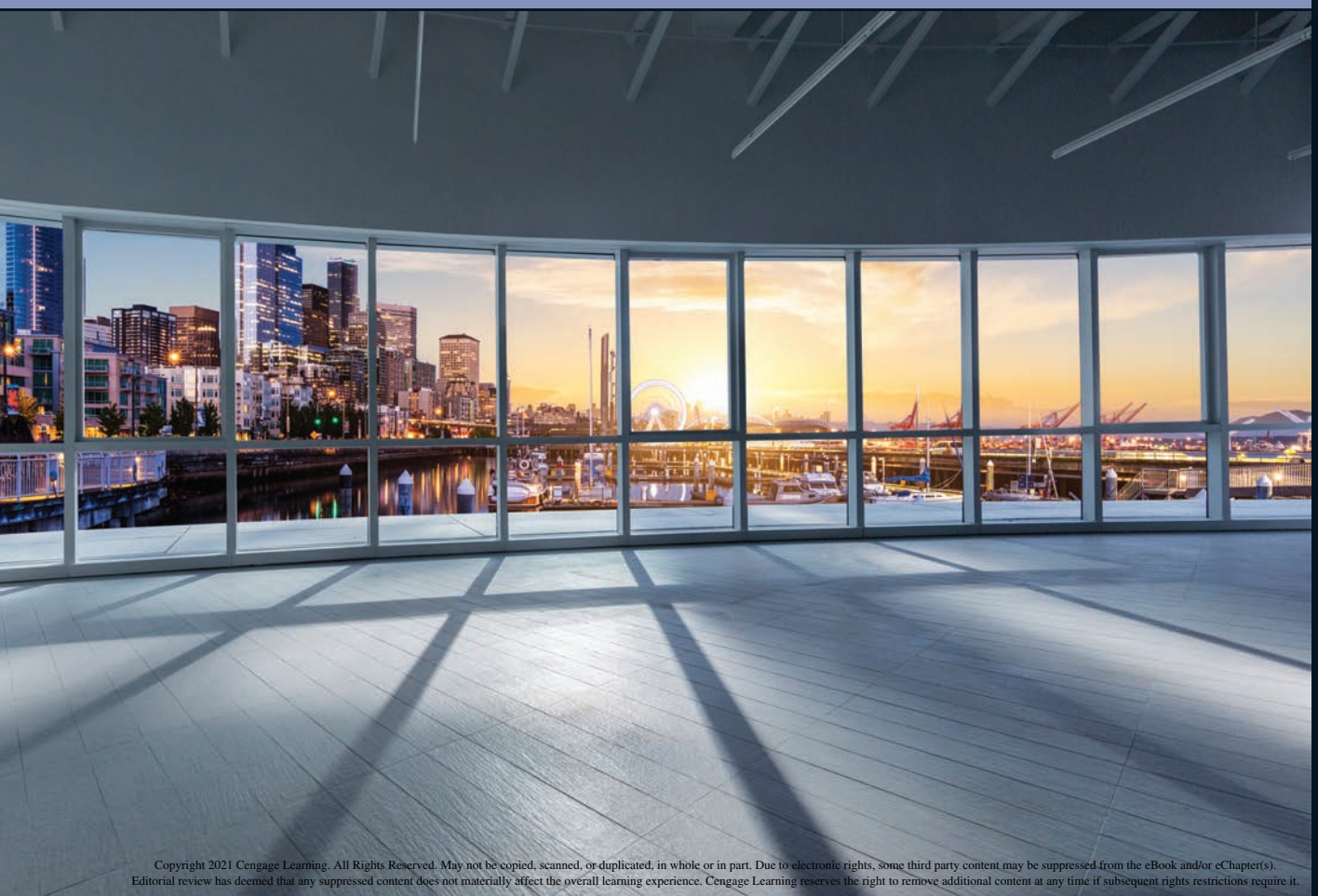
PART 3

Open System Design Elements

Chapter 4 The External Environment
Chapter 5 Interorganizational Relationships
Chapter 6 Designing Organizations for the International Environment
Chapter 7 Designs for Societal Impact: Dual-Purpose Organizations, Corporate Sustainability, and Ethics



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CHAPTER

4 The External Environment

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Learning Objectives

After reading this chapter you should be able to:

1. Describe how the influence of the general environment on an organization is different from that of the task environment.
2. Explain the difference between environmental complexity and environmental dynamism.
3. Describe how complexity and dynamism together can be used to assess the level of uncertainty in an organization's environment.
4. Explain approaches organizations can use to adapt to complexity and dynamism in a changing environment.
5. Explain how the environment affects organizational differentiation and integration.
6. Describe how the environment affects organic versus mechanistic management processes.
7. Describe the techniques organizations can use to control financial resources in the external environment.

Chapter Outline

The Organization's Environment

Task Environment • General Environment • International Environment

The Changing Environment

Complexity • Dynamism • Framework

Adapting to Complexity and Dynamism

Adding Positions and Departments • Building Relationships • Differentiation and Integration • Organic Versus Mechanistic Management Processes • Planning, Forecasting, and Responsiveness

Framework for Adapting to Complexity and Dynamism

Dependence on Financial Resources

Influencing Financial Resources

Establishing Formal Relationships • Influencing Key Sectors

Organization–Environment Integrative Framework

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **The best way for an organization to cope with a complex environment is to develop a complex structure (rather than keep it simple and uncomplicated).**

I AGREE _____ I DISAGREE _____

2 **In a volatile, fast-changing environment, serious planning activities are a waste of time and resources.**

I AGREE _____ I DISAGREE _____

3 **Managers of business organizations should not get involved in political activities.**

I AGREE _____ I DISAGREE _____

No one knows for sure why the unidentified man slashed a tire on the innocent van idling at an intersection in Chandler, Arizona. *Wait a minute*, say some residents in the city of Chandler, *maybe that van wasn't so innocent after all.* It was a self-driving vehicle operated by Waymo, a division of Alphabet, and it wasn't the first or the last one to be attacked. The tire-slashing was one of dozens of attacks on self-driving vehicles that Waymo has been testing in Chandler, a city near Phoenix. People have waved guns at the vans, tried to run them off the road, pelted them with rocks, and threatened Waymo employees riding inside them with pieces of pipe and other objects. Waymo began testing its driverless vehicles in 2017 and quickly learned that the public has a lot of misgivings about the new technology. "They said they need real-world examples, but I don't want to be their real-world mistake," said one Chandler resident.[1]

Waymo's experience might be an extreme example because it involves such a recent technology, but all organizations face tremendous uncertainty in dealing with events in the external environment. The giant packaged food companies such as General Mills, Kraft Heinz, and Kellogg, for example, are seeing their market share decline as consumers increasingly turn to fresh foods and more natural and organic choices.[2] Cybercrime, such as recent data breaches at Dunkin Donuts, Under Armour, Rush University Medical System, and Georgia Institute of Technology (Georgia Tech), is a growing threat from the environment to every organization. Most organizations at some point have to adapt quickly to new competition, economic turmoil, changes in consumer interests, or innovative technologies. Changes in the environment can create both threats and opportunities for organizations.

Purpose of This Chapter

The purpose of this chapter is to develop a framework for assessing environments and how organizations can respond to them. First, we identify the organizational domain and the sectors that influence the organization. Then we explore two major environmental forces on the organization—the need for information and the need for financial resources. Organizations respond to these forces through structural design, planning systems, and attempts to adapt to and influence various people, events, and organizations in the external environment.

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4.1 The Organization's Environment

In a broad sense the environment is infinite and includes everything outside the organization. However, the analysis presented here considers only those aspects of the environment to which the organization is sensitive and must respond to survive. Thus, **organizational environment** is defined as everything that exists outside the boundary of the organization and has the potential to affect all or part of the organization.

The environment of an organization can be understood by analyzing its domain within external sectors. An organization's **domain** is the chosen environmental field of action. It is the territory an organization stakes out for itself with respect to products, services, and markets served. Domain defines the organization's niche and defines those external sectors with which the organization will interact to accomplish its goals.

The environment comprises several **sectors** or subdivisions that contain similar elements. Eleven sectors can be analyzed for each organization: industry, raw materials, human resources, financial resources, market, technology, economic conditions, government, natural, sociocultural, and international. The sectors and a hypothetical organizational domain are illustrated in Exhibit 4.1. For most companies, the sectors in Exhibit 4.1 can be further categorized as either the task environment or the general environment.

BRIEFCASE

As an organization manager, keep this guideline in mind:

Organize elements in the external environment into 11 sectors for analysis: industry, raw materials, human resources, financial resources, market, technology, economic conditions, government, natural, sociocultural, and international. Focus on sectors that may experience significant change at any time.

4.1a Task Environment

The **task environment** includes sectors with which the organization interacts directly and that have a direct impact on the organization's ability to achieve its goals. The task environment typically includes the industry, raw materials, and market sectors, and perhaps the human resources and international sectors.

The following examples illustrate how each of these sectors can affect organizations:

- In the *industry sector*, the retail industry in South Korea has always been dominated by big department stores, but as smartphone use surged in the country over the past few years, companies saw new ways to reach consumers. South Korea has a low number of women in the workforce, so there is a ready audience of affluent television and Internet shoppers. Online and home shopping competitors are growing in popularity, and posters on subway station walls allow people to make purchases simply by snapping a picture of a barcode.[3]
- In the *raw materials sector*, sales growth at Adidas slowed in early 2019 because the company's suppliers in Asia were having trouble keeping pace with the fast growth as Adidas shifted more production from high-end products to mid-priced clothing. As another example, Tyson Foods invested hundreds of millions of dollars to build 90 chicken farms in China to guarantee a supply of high-quality birds, which the company then processes and sells to fast food companies, wholesalers, and other meatpackers in the country that use the meat in sausage and other products.[4]

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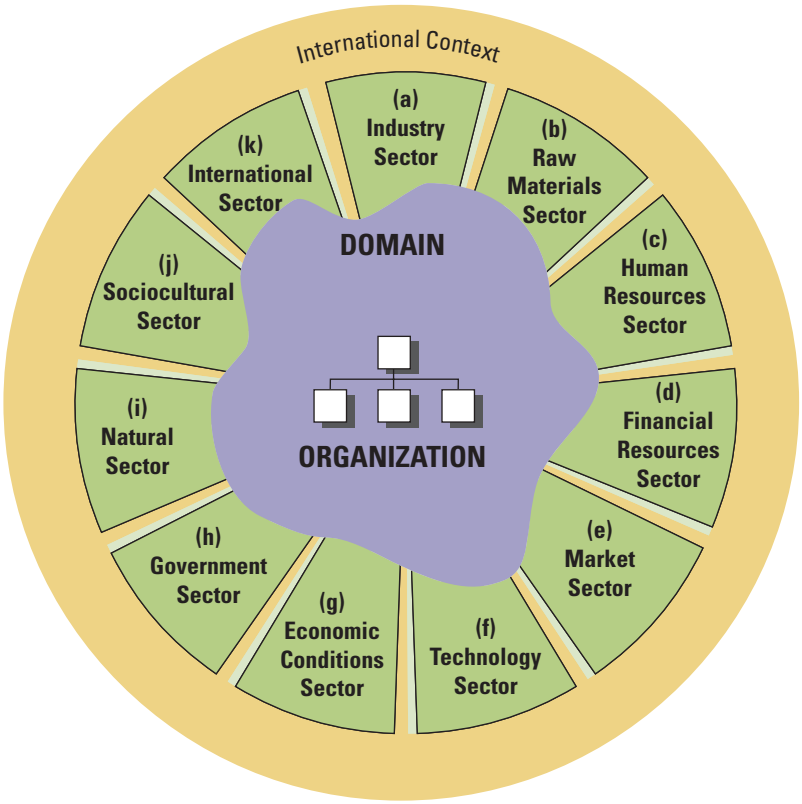
EXHIBIT 4.1
An Organization's Environment



(a) Competitors, industry size and competitiveness, related industries

(b) Suppliers, manufacturers, real estate, services

(c) Labor market, employment agencies, universities, training schools, employees in other companies, unionization

(d) Stock markets, banks, savings and loans, private investors

(e) Customers, clients, potential users of products and services

(f) Techniques of production, science, computers, information technology, e-commerce

(g) Recession, unemployment rate, inflation rate, rate of investment, economics, growth

(h) City, state, federal laws and regulations, taxes, services, court system, political processes

(i) Green movement, sustainability, natural resource management

(i) Age, values, beliefs, education, religion, work ethic, consumer movements

(j) Competition from and acquisition by foreign firms, entry into overseas markets, foreign customs, regulations, exchange rate

- In the *market sector*, executives at Univision Communications Inc.'s flagship Spanish-language television network are working to adapt programming to appeal to younger and U.S. born Hispanics. Nearly 60 percent of Hispanics in the United States are Millennials or younger, so managers know it is essential to add edgier, more fast-paced programs that interest this large segment of the market.[5]

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- The *human resources sector* is of significant concern to every business. A tight labor market is affecting organizations in all industries. Even the FBI is having trouble finding enough qualified candidates for the 900 or so special agent positions that open each year. The agency received 68,500 applications in 2009 for the coveted positions, but that number was down to 11,500 in the year ending September 2018. Officials say it takes about 16,000 applicants to get a healthy pool of candidates to fill the special agent jobs.[6]
- For most companies today, the *international sector* is also a part of the task environment because of globalization and intense competition. For example, thousands of products were removed from Amazon.com's India website in early 2019 after that country's new e-commerce rules went into effect. The new restrictions are aimed at helping local retailers better compete against foreign-owned giants such as Amazon. The rules could affect as much as 40 percent of Amazon's sales in India.[7]

4.1b General Environment

The **general environment** includes those sectors that might not have a direct impact on the daily operations of a firm but will indirectly influence it. The general environment often includes the government, natural, sociocultural, economic conditions, technology, and financial resources sectors. These sectors affect all organizations eventually. Consider the following examples:

- In the *government sector*, regulations influence every phase of organizational life. In addition, companies often find themselves fighting legal battles in local or national courts. Johnson & Johnson, for example, is facing thousands of lawsuits over the safety of its baby powder, and juries have already returned some multi-million-dollar verdicts against the company.[8]
- The *natural sector* of the external environment, including all elements that occur naturally on Earth, is of growing importance as consumers, organizations, and managers become increasingly sensitive to diminishing natural resources and the environmental impact of a company's products and business practices. Caesars Entertainment, one of the world's largest gaming companies, created a scorecard to keep track of how well the company was doing at reducing energy consumption, recycling waste, and meeting other "green" goals. Managers found that the more information guests had about Caesars' environmental practices, the better they felt about the company and the more likely they were to enjoy their stay at the casino and to book future visits.[9] Protection of the natural environment is also emerging as a critical policy focus around the world. The chart below shows the five countries with the best performance on one environmental performance index, along with several comparison countries.[10]

Rank	Country	Score
1.	Switzerland	87.42
2.	France	83.95
3.	Denmark	81.60
4.	Malta	80.90
5.	Sweden	80.51
25.	Canada	72.18

Rank	Country	Score
27.	United States	71.19
32.	Qatar	67.80
52.	Russia	63.79
72.	Mexico	59.69
120.	China	50.74
177.	India	30.57

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- One significant element in the *sociocultural sector* is pressure from various advocacy groups. An amusing example comes from Nabisco and its parent company Mondelez International, where managers decided under pressure from People for the Ethical Treatment of Animals (PETA) to let the animals on its circus-themed Barnum's Animal Crackers boxes (caged for more than a century) roam free. The box now shows a zebra, gorilla, elephant, lion, and giraffe wandering side by side rather than captured behind bars. "Big victories can come in small packages," PETA's website proclaimed about the package redesign. "The new box . . . perfectly reflects that our society no longer tolerates caging and chaining exotic animals for circus shows."[11]
- General *economic conditions* often affect the way a company must do business. Looking back, the global recession that began in 2008 affected companies in all industries. For example, Briggs Inc., a small New York City company that plans customized events for corporations wanting to woo top clients or reward staff or client loyalty, had to make some changes when it began losing customers. Briggs began looking for ways to save clients money, such as moving events to smaller venues, scaling down décor, and adding extras that didn't add to the cost. The strategy was a financial burden for Briggs, but it helped the company hold onto clients for the long term.[12]
- The *technology sector* is an area in which massive changes continue to occur because of the rise in artificial intelligence (AI) and digital technologies. In countries from the United States to Canada to Japan, studies have found substantial drops in white-collar jobs linked to adoption of new technology. Today, AI software is picking out worrisome spots on medical scans, spotting profits in stock trades in milliseconds, sifting through documents for evidence in court cases, and recording power usage beamed from digital utility meters in millions of homes.[13] Yet technology also can create jobs in new areas. Several companies are working on technology for driverless cars. Waymo, described in the chapter opening example, launched Waymo One, the country's first commercial ride-share service using self-driving cars, for limited service in late 2018.[14]
- All businesses have to be concerned with *financial resources*, and this sector is often first and foremost in the minds of entrepreneurs. Many small-business owners turned to online person-to-person (P-to-P) lending networks for small loans because of banks' tight lending standards. Jeff Walsh, for example, borrowed around $22,000 through Prosper.com for his coin laundry business. Alex Kalempa needed $15,000 to expand his business of developing racing shift systems for motorcycles, but banks offered him credit lines of only $500 to $1,000. Kalempa went to LendingClub.com, where he got the $15,000 loan at an interest rate several points lower than the banks were offering.[15]

4.1c International Environment

The international sector can directly affect many organizations, and it has become extremely important in the last few years. The auto industry, for example, has experienced profound shifts as China emerged as the world's largest auto market. In response, some car makers have moved international headquarters into China and have been designing features that appeal to the Chinese market, including

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bigger, limousine-like back seats, advanced entertainment systems, and light-colored interiors.[16] Ride-sharing service Uber was also hoping to tap into China's huge market, but eventually sold its business in that country to Chinese-owned Didi Chuxing.

IN PRACTICE

Uber and Didi Chuxing

MARKA/Alamy Stock Photo

Many people in the United States might think Uber is the king of ride-hailing services, but Chinese entrepreneur Cheng Wei would argue that title belongs to his startup firm Didi Chuxing (formerly Didi Kuaidi). Didi is the largest ride-hailing app in the world.

Uber had bold ambitions to conquer the Chinese ride-sharing market. Managers made frequent trips to China to develop political relationships and build an extensive network of drivers in the country. But they found the complexity of China too tough to crack. As Jeff Immelt, former CEO of GE, once said about entering the Chinese market, "China is big, but it is hard." Uber's managers needed to overcome numerous obstacles—different banking and financial systems, complex political and legal systems, frustrating rules and regulations, and puzzling cultural differences. After two years operating in China and racking up more than $2 billion in losses, managers agreed to sell Uber's Chinese business to Didi Chuxing.[17]

Every company faces tremendous uncertainty when it enters an international market. International events can also influence all the domestic sectors of the environment. For example, adverse weather and a workers' strike in Western Africa, which supplies about two-thirds of the world's cocoa beans, sharply increased raw material costs for Choco-Logo, a small maker of gourmet chocolates in Buffalo, New York.[18] Countries and organizations around the world are connected as never before, and economic, political, and sociocultural changes in one part of the world eventually affect other areas.

All organizations have to adapt to both subtle and massive shifts in the environment. In the following sections, we discuss in greater detail how companies can cope with and respond to environmental complexity and dynamism.

REMEMBER THIS

- Organizations are open social systems. Most are involved with hundreds of elements in the external environment, and the environment can be incredibly complex.
- Changes in an organization's environment create both threats and opportunities. The environment of an organization can be understood by analyzing the organization's domain, which defines those external sectors with which the organization will interact to accomplish its goals.
- Sectors of the task environment include the industry, raw materials, market, human resources, and international. Sectors of the general environment include government, natural, sociocultural, economic conditions, technology, and financial resources.

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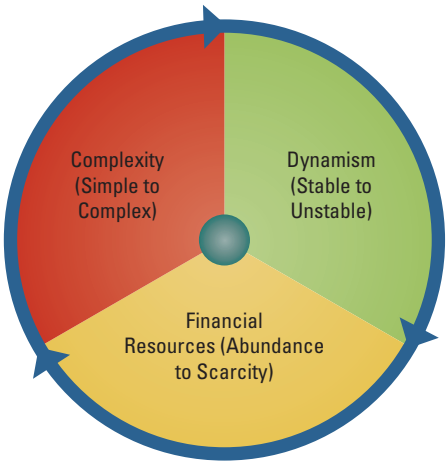
4.2 The Changing Environment

How does the environment influence an organization? The patterns and events occurring in the environment can be described along three primary dimensions: dynamism (whether events in the environment are stable or unstable), complexity (whether the environment is simple or complex), and abundance (amount of financial resources available to support the organization's growth).[19] These dimensions are illustrated in Exhibit 4.2. As the environment becomes more complex, events become less stable, and financial resources become less available, the level of uncertainty increases. These dimensions boil down to two essential ways the environment influences organizations: (1) the need for information about changes in the environment and (2) the need for resources from the environment. The environmental conditions of complexity and dynamism create a greater need to gather information and to respond to changes based on that information. The organization also is concerned with scarce financial resources and with the need to ensure availability of resources, which will be discussed later in this chapter.

Environmental uncertainty pertains primarily to those sectors illustrated in Exhibit 4.1 that an organization deals with on a regular, day-to-day basis. Although sectors of the general environment—such as economic conditions, social trends, or technological changes—can create uncertainty for organizations, determining an organization's environmental uncertainty generally means focusing on sectors of the *task environment*, such as how many elements (e.g., people, other organizations, events) the organization deals with regularly and how rapidly these various elements change. To assess uncertainty, each sector of the organization's task environment can be analyzed along dimensions such as stability or instability and degree of complexity.[20] The total amount of uncertainty felt by an organization is the uncertainty accumulated across relevant task environment sectors.

Organizations must cope with and manage uncertainty to be effective. **Uncertainty** means that decision makers do not have sufficient information about environmental factors, and they have a difficult time predicting external changes. Uncertainty increases the risk of failure for organizational decisions and makes it difficult to compute costs and probabilities associated with decision alternatives.[21] The remainder of this section will focus on the information perspective, which is concerned with uncertainty created by the extent to which the environment is

EXHIBIT 4.2
Factors Causing Uncertainty for the Organization



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complex and the extent to which events are dynamic. Later in the chapter, we discuss how organizations influence the environment to acquire needed financial resources.

4.2a Complexity

Environmental **complexity** refers to heterogeneity, or the number and dissimilarity of external elements (e.g., competitors, suppliers, industry changes, government regulations) that affect an organization's operations. The more external elements regularly influence the organization and the greater the number of other companies in an organization's domain, the greater the complexity. A complex environment is one in which the organization interacts with, and is influenced by, numerous diverse external elements. In a simple environment, the organization interacts with and is influenced by only a few similar external elements.

For example, a family-owned hardware store in a suburban community is in a simple environment. The store does not have to deal with complex technologies or extensive government regulations, and cultural and social changes have little impact. Human resources are not a problem because the store is run by family members and part-time help. The only external elements of real importance are a few competitors, suppliers, and customers. On the other hand, pharmaceutical companies such as Abbott Laboratories, Merck, and Pfizer operate in a highly complex environment. They use multiple, complex technologies; cope with numerous ever-changing government regulations; are significantly affected by international events; compete for scarce financial resources and highly trained scientists; interact with numerous suppliers, customers, contractors, and partners; respond to changing social values; and deal with complex legal and financial systems in multiple countries. This large number of external elements in a drug company's domain creates a complex environment. Abbott split into two separate companies to better cope with the complexity of the environment. Other companies, such as Merck and Schering Plough, merged to better cope with uncertainty.[22]

4.2b Dynamism

Dynamism refers to whether the environment in which the organization operates is stable or unstable. An environmental domain is stable if it remains essentially the same over a period of months or years. Under unstable conditions, environmental elements shift rapidly. For example, an organization might experience major fluctuations in demand for its products or in prices charged by suppliers, competitors might be releasing better and faster innovations, or the regulatory environment for the industry might be undergoing rapid shifts.[23] Consider how the dynamic environment for fashion retailers such as Gap Inc. can cause a company to struggle.

IN PRACTICE

Gap Inc.

"Gap's brand is not terribly cool, and it's overpriced," said a young Los Angeles shopper. That's a big change for the company that once controlled the U.S. market for casual fashion.

One of the biggest challenges Gap managers face is that consumer preferences are changing rapidly and rivals have been quicker to address those desires. Gap follows the traditional model of ordering inventory at the beginning of the season and sending merchandise to the stores. If the clothes don't sell, they linger on the racks and shelves,

Ken Wolter/Shutterstock.com

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destined for a series of price markdowns until the next large order. All orders have to be approved at the corporate level. Rival Zara, on the other hand, follows a "fast-fashion" model, continually sending small batches of clothing to stores and seeing how customers respond. If the items sell well, the company can get additional products on the shelves within days. Zara employees or an agent can authorize new stock on the spot rather than having to submit orders to headquarters and wait for approval.

Gap managers have implemented a few changes aimed at responding more quickly to the dynamic fashion environment. They now encourage employees to share information across the company's different brands, such as Old Navy, Banana Republic, Athleta, and Intermix, so the company gets a better picture of what consumers are interested in. The CEO is also pushing data analytics so Gap can stay on top of quickly shifting trends. So far, though, Gap hasn't found the right formula. One former customer who grew up wearing Gap clothes says the company keeps coming out with "the same thing, over and over again." She says Zara has "styles that can fit any personality. Even their emails make me want to go into the stores." In early 2019, Gap announced that it would close more than 200 stores over a two-year period and spin off the Old Navy brand as a separate company.[24]

As the Gap example shows, shifts in the environment, whether consumer tastes, new technologies, or competitor innovations, can cause a company to quickly fall behind. Sometimes specific, unpredictable events create unstable conditions for an organization. In April 2019, for example, hackers posted the personal information of hundreds of FBI and Secret Service agents. Today, freewheeling bloggers, Twitterers, and YouTubers are a tremendous source of instability for scores of companies. For example, when United Airlines refused to compensate a musician for breaking his $3,500 guitar, he wrote a song and posted a derogatory music video about his lengthy negotiations with the company on YouTube. Word spread quickly across the Internet, and United just as quickly responded with a settlement offer.[25]

Environmental domains are increasingly unstable for most organizations.[26] This chapter's BookMark examines the volatile nature of today's business world and gives some tips for managing in a fast-shifting environment. Although environments are more unstable for most organizations today, an example of a traditionally stable environment is a public utility.[27] In the rural Midwest, demand and supply factors for a public utility are stable. A gradual increase in demand may occur, which is easily predicted over time. Toy companies, by contrast, have an unstable environment. Hot new toys are difficult to predict, a problem compounded by the fact that children are losing interest in toys at a younger age, their interest captured by video and computer games, electronics, and the Internet. Adding to the instability for toymakers is the shrinking retail market, with big toy retailers going out of business trying to compete with discounters such as Walmart. Toymakers are trying to attract more customers in developing markets such as China, Poland, Brazil, and India to make up for the declining U.S. market, but hitting the target in those countries has proven to be a challenge. Companies such as Fisher-Price, owned by Mattel, can find their biggest products languishing on shelves as shoppers turn to less expensive locally made toys in countries where brand consciousness doesn't come into play. As one toy analyst said, "Chinese kids have been growing for 5,000 years without the benefits of Fisher-Price."[28]

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4.2c Framework

The simple–complex and stable–unstable dimensions are combined into a framework for assessing environmental uncertainty in Exhibit 4.3. In the *simple, stable* environment, uncertainty is low. There are only a few external elements in a limited number of environmental sectors (e.g., suppliers, customers) to contend with, and they tend to remain stable. The *complex, stable* environment represents somewhat greater uncertainty. A large number of elements (e.g., suppliers, customers, government regulations, industry changes, unions, economic conditions) have to be scanned, analyzed, and acted upon for the organization to perform well. External elements do not change rapidly or unexpectedly in this environment.

BOOKMARK 4.0 HAVE YOU READ THIS BOOK?

Confronting Reality: Doing What Matters to Get Things Right

By Lawrence A. Bossidy and Ram Charan

The business world is changing at an increasingly rapid pace. That is the reality that spurred Larry Bossidy, retired chairman and CEO of Honeywell International, and Ram Charan, a noted author, speaker, and business consultant, to write *Confronting Reality: Doing What Matters to Get Things Right*. Too many managers, they believe, are tempted to hide their heads in the sand of financial issues rather than face the confusion and complexity of the organization's environment.

LESSONS FOR FACING REALITY

For many companies, today's environment is characterized by global hypercompetition, declining prices, and the growing power of consumers. Bossidy and Charan offer some lessons to leaders for navigating in a fast-changing world:

- *Understand the environment as it is now and is likely to be in the future, rather than as it was in the past.* Relying on the past and conventional wisdom can lead to disaster. Kmart, for example, stuck to its old formula as Walmart gobbled its customers and carved out a new business model. Few could have predicted in 1990, for example, that Walmart would now be America's biggest seller of groceries.
- *Seek out and welcome diverse and unorthodox ideas.* Managers need to be proactive and open-minded toward conversing with employees, suppliers, customers, colleagues, and anyone else they come in contact with. What are people thinking about? What changes and opportunities do they see? What worries them about the future?
- *Avoid the common causes of manager failure to confront reality: filtered information, selective hearing, wishful thinking, fear, emotional overinvestment in a failing course of action, and unrealistic expectations.* For example, when sales and profits fell off a cliff at data-storage giant EMC, managers displayed a bias toward hearing good news and believed the company was only experiencing a blip in the growth curve. When Joe Tucci was named CEO, however, he was determined to find out if the slump was temporary. By talking directly with top leaders at his customers' organizations, Tucci was able to face the reality that EMC's existing business model based on high-cost technology was dead. Tucci implemented a new business model to fit that reality.
- *Ruthlessly assess your organization.* Understanding the internal environment is just as important. Managers need to evaluate whether their company has the talent, commitment, and attitude needed to drive the important changes. At EMC, Tucci realized his salesforce needed an attitude shift to sell software, services, and business solutions rather than just expensive hardware. The arrogant, hard-driving sales tactics of the past had to be replaced with a softer, more customer-oriented approach.

STAYING ALIVE

Staying alive in today's business environment requires that managers stay alert. Managers should always be looking at their competitors, broad industry trends, technological changes, shifting government policies, changing market forces, and economic developments. At the same time, they work hard to stay in touch with what their customers really think and really want. By doing so, leaders can confront reality and be poised for change.

Confronting Reality: Doing What Matters to Get Things Right, by Lawrence A. Bossidy and Ram Charan, is published by Crown Business Publishing.

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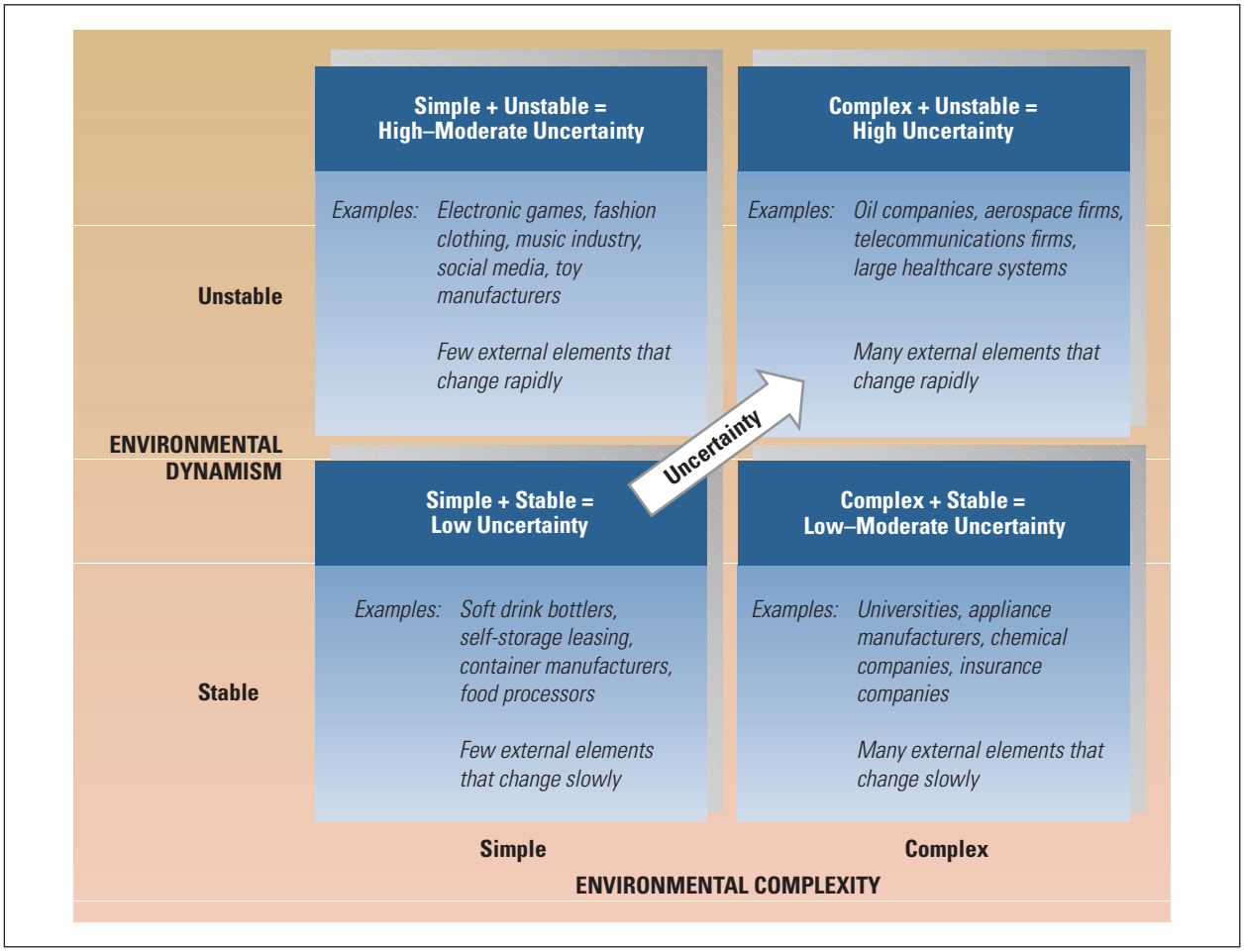
EXHIBIT 4.3
Framework for Assessing Environmental Uncertainty


Simple + Unstable = High–Moderate Uncertainty
Examples: Electronic games, fashion clothing, music industry, social media, toy manufacturers
Few external elements that change rapidly
Complex + Unstable = High Uncertainty
Examples: Oil companies, aerospace firms, telecommunications firms, large healthcare systems
Many external elements that change rapidly
Unstable
ENVIRONMENTAL DYNAMISM
Uncertainty
Simple + Stable = Low Uncertainty
Examples: Soft drink bottlers, self-storage leasing, container manufacturers, food processors
Few external elements that change slowly
Complex + Stable = Low–Moderate Uncertainty
Examples: Universities, appliance manufacturers, chemical companies, insurance companies
Many external elements that change slowly
Stable
Simple
Complex
ENVIRONMENTAL COMPLEXITY

Sources: Based on Robert Duncan, "Characteristics of Organizational Environments and Perceived Environmental Uncertainty," *Administrative Science Quarterly* 17 (September 1972), 313–327; Robert B. Duncan, "Multiple Decision-Making Structures in Adapting to Environmental Uncertainty: The Impact on Organizational Effectiveness," *Human Relations* 26, no. 3 (1973), 273–291; and Robert B. Duncan, "Modifications in Decision Structure in Adapting to the Environment: Some Implications for Organizational Learning," *Decision Sciences* 5, no. 4 (October 1974), 705–725.

Even greater uncertainty is felt in the *simple, unstable* environment.[29] Rapid change creates uncertainty for managers. Even though the organization has few external elements, those elements are hard to predict (such as shifting social trends or changing customer interests), and they react unexpectedly to organizational initiatives. The greatest uncertainty for an organization occurs in the *complex, unstable* environment. A large number of elements in numerous environmental sectors impinge upon the organization, and they shift frequently or react strongly to organizational initiatives. When several sectors change simultaneously, the environment becomes turbulent.[30]

A soft drink distributor functions in a simple, stable environment. Demand changes only gradually. The distributor has an established delivery route, and supplies of soft drinks arrive on schedule. State universities, appliance manufacturers, and insurance companies are in somewhat stable, complex environments. A large number of external elements are present, but although they change, changes are gradual and predictable.

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Toy manufacturers are in simple, unstable environments. Organizations that design, make, and sell toys, as well as those that make electronic games or are involved in the clothing or music industry, face shifting supply and demand. Although there may be few elements to contend with—for example, suppliers, customers, competitors—they are difficult to predict and change abruptly and unexpectedly.

The telecommunications industry, the oil industry, and airlines face complex, unstable environments. Many external sectors are changing simultaneously. In the case of airlines, in just a few years the major carriers were confronted with an air-traffic controller shortage, aging fleets of planes, labor unrest, soaring fuel prices, the entry of new low-cost competitors, a series of major air-traffic disasters, and a drastic decline in customer demand. Within just a few years, four large airlines and many smaller ones went through bankruptcy, and the airlines collectively laid off 170,000 employees.[31]

REMEMBER THIS

- Changes in the environment can de described along three primary dimensions: dynamism (whether events are stable or unstable), complexity (whether the environment is simple or complex), and abundance (amount of financial resources available).
- The dimensions of dynamism (stable–unstable) and complexity (simple–complex) can be combined into a framework for assessing environmental uncertainty.
- For an organization in a simple, stable environment, uncertainty is low. There are only a few external elements (such as customers or suppliers) that the organization must deal with, and they change slowly.
- An organization that functions in a complex, stable environment experiences low to moderate uncertainty. There are a large number of elements the organization must deal with (such as customers, suppliers, government regulations, labor market, and raw materials), but they do not change rapidly or unexpectedly.
- An organization operating in a simple, unstable environment experiences moderate to high uncertainty. Although there are only a few external elements to contend with, these are hard to predict and may change quickly or unexpectedly (such as changing social trends).
- The greatest uncertainty occurs in a complex, unstable environment. The organization must deal with numerous external elements in various sectors of the environment and these elements may shift frequently and sometimes unexpectedly.

4.3 Adapting to Complexity and Dynamism

Once you see how environments differ with respect to dynamism and complexity, the next question is, "How do organizations adapt to each level of environmental uncertainty?" Environmental uncertainty represents an important contingency for organization structure and internal behaviors. Recall from Chapter 3 that organizations facing uncertainty often use structural mechanisms that encourage horizontal communication and collaboration to help the company adapt to changes in the environment. In this section we discuss in more detail how the environment affects organizations. An organization in a certain environment will be managed

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and controlled differently from an organization in an uncertain environment with respect to positions and departments, organizational differentiation and integration, control processes, and future planning and forecasting. Organizations need to have the right fit between internal structure and the external environment.

4.3a Adding Positions and Departments

As complexity and uncertainty in the external environment increase, so does the number of positions and departments within the organization, leading to increased internal complexity. This relationship is part of being an open system. Each sector in the external environment requires an employee or department to deal with it. The human resource department deals with unemployed people who want to work for the company. The marketing department finds customers. Procurement employees obtain raw materials from hundreds of suppliers. The finance group deals with bankers. The legal department works with the courts and government agencies. E-business departments handle electronic commerce, and information technology departments deal with the increasing complexity of digital information and knowledge management systems.

Adding new positions and departments is a common way for organizations to adapt to growing environmental uncertainty. Companies such as Johnson & Johnson, Philips Electronics, and PepsiCo have added chief design officer positions to their senior ranks to beef up the development and marketing of products in an environment where consumers are paying more attention to appealing design. Many companies have added diversity officer positions in recent years. WarnerMedia created a new position of Chief Diversity and Inclusion Officer after employees questioned the lack of female and minority leaders during question-and-answer sessions following AT&T's acquisition of Time Warner.[32]

4.3b Building Relationships

The traditional approach to coping with environmental uncertainty was to establish buffer departments. The purpose of **buffering roles** is to absorb uncertainty from the environment.[33] The technical core performs the primary production activity of an organization. Buffer departments surround the technical core and exchange materials, resources, and money between the environment and the organization. They help the technical core function efficiently. The purchasing department buffers the technical core by stockpiling supplies and raw materials. The human resource department buffers the technical core by handling the uncertainty associated with finding, hiring, and training production employees.

A more recent approach many organizations use is to drop the buffers and expose the technical core to the uncertain environment. These organizations no longer create buffers because they believe being well connected to customers and suppliers is more important than internal efficiency. Highly uncertain environments require rapid transfer of information and knowledge so the organization can adapt quickly. Teams, as described in Chapter 3, often work directly with customers and other parties outside the organization.[34] At Total Attorneys, a Chicago-based company that provides software and services to small law firms, cross-functional teams work with customers who test and provide feedback on products as they are developed.[35] Opening up the organization to the environment by building closer relationships with external parties makes it more fluid and adaptable.

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Boundary-spanning roles link and coordinate an organization with key elements in the external environment. Boundary spanning is primarily concerned with the exchange of information to detect and bring into the organization information about changes in the environment and to send information into the environment that presents the organization in a favorable light.[36]

Organizations have to keep in touch with what is going on in the environment so that managers can respond to market changes and other developments. A study of high-tech firms found that 97 percent of competitive failures resulted from lack of attention to market changes or the failure to act on vital information.[37] To detect and bring important information into the organization, boundary personnel scan the environment. For example, a market research department scans and monitors trends in consumer tastes. Boundary spanners in engineering and research and development departments scan new technological developments, innovations, and raw materials. Boundary spanners prevent the organization from stagnating by keeping top managers informed about environmental changes. The greater the uncertainty in the environment, the greater the importance of boundary spanners.[38] Recall that toy companies operate in uncertain environments. The toy and game maker Hasbro effectively used boundary spanners to discern in the mid-1990s that technology would likely change competition in the industry, so managers stayed abreast of technical changes. In addition, detecting other patterns such as a falling birth rate, greater ethnic diversity in the U.S. population, and more households with two incomes helped managers position Hasbro to remain competitive and successful as changes occurred.[39]

One approach to boundary spanning is **business intelligence**, which refers to the high-tech analysis of large amounts of internal and external data to spot patterns and relationships that might be significant. Verizon uses business intelligence to actively monitor customer interactions so that it can catch problems and fix them almost immediately.[40] Tools to automate the process are a hot area of software, with companies spending billions on business intelligence software in recent years.[41] Another interesting example is how colleges and universities are using software to track data on prospective students.

IN PRACTICE

Seton Hall University and Dickinson College

If you've submitted an application to attend Seton Hall University, Dickinson College, or any of another number of schools, enrollment officers know right down to the second when you opened the e-mails the school has sent you, how long you spent reading them, and whether you clicked through to any links. Schools use that and other information to help them determine your "demonstrated interest."

Software from companies such as Technolutions Inc. helps track which applicants are truly interested in the school versus those who have simply applied to a large number of schools. Technolutions generates a dashboard summarizing thousands of data points on each applicant. The company's CEO says its product is now used by more than 800 schools.

Demonstrated interest is of growing importance to colleges and universities because many are getting an increasing number of applicants and the schools want to make good decisions about which ones to accept. At Seton Hall, students get a score based on 80 variables that help determine whether they are likely to enroll if accepted.[42]

Colleges, as well as business organizations, are also using social media analytics, which refers to gathering and analyzing data from social media platforms to help make decisions about specific issues. Marriott International operates a social media center where employees analyze Twitter feeds, Instagram photos, Facebook posts, and other social media to keep up with the latest trends.[43]

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Business intelligence is related to another important area of boundary spanning, known as *competitive intelligence* (CI). CI gives top executives a systematic way to collect and analyze public information about rivals and use it to make better decisions.[44] Using techniques that range from Internet surfing to digging through trash cans, intelligence professionals dig up information on competitors' new products, manufacturing costs, or training methods and share it with top leaders. Intelligence teams are the newest wave of CI activities. An **intelligence team** is a cross-functional group of managers and employees, usually led by a CI professional, who work together to gain a deep understanding of a specific business issue, with the aim of presenting insights, possibilities, and recommendations to top leaders.[45] Intelligence teams can provide insights that enable managers to make more informed decisions about goals, as well as devise contingency plans and scenarios related to major competitive issues.

The boundary task of sending information into the environment to represent the organization is used to influence other people's perception of the organization. In the marketing department, advertising and salespeople represent the organization to customers. Purchasers may call on suppliers and describe purchasing needs. The legal department informs lobbyists and elected officials about the organization's needs or views on political matters. Many companies set up special web pages and blogs to present the organization in a favorable light.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Scan the external environment for threats, changes, and opportunities. Use boundary-spanning roles, such as market research and intelligence teams, to bring into the organization information about changes in the environment. Enhance boundary-spanning capabilities when the environment is uncertain.

1 The best way for an organization to cope with a complex environment is to develop a complex structure (rather than keep it simple and uncomplicated).

ASSESS YOUR ANSWER

ANSWER: *Agree.* As an organization's environment becomes more complex, the organization has to add jobs, departments, and boundary-spanning roles to cope with all the elements in the environment. When environmental sectors are complex, there is no way for an organization to stay simple and uncomplicated and continue to be effective.

REMEMBER THIS

- Organizations may adapt to complexity and dynamism by adding specific departments and functions to deal with uncertainties and by establishing buffering and boundary-spanning roles.
- As external environmental uncertainty increases, internal complexity increases as well. Under great uncertainty, managers allocate more resources to departments that will plan, deal with specific environmental elements, and integrate diverse internal activities.
- The organization can be conceptualized as a technical core, and buffering departments absorb uncertainty from the environment.
- Boundary-spanning roles bring information about the environment into the organization and send information about the organization to the external environment.
- Business intelligence, including social media analytics, is one approach to boundary spanning.

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4.3c Differentiation and Integration

Another response to environmental uncertainty is the amount of differentiation and integration among departments. Organizational **differentiation** refers to "the differences in cognitive and emotional orientations among managers in different functional departments, and the difference in formal structure among these departments."[46] When the external environment is complex and rapidly changing, organizational departments become highly specialized to handle the uncertainty in that part of the external environment each department works with. Success in each environmental sector (human resources, technology, government, and so forth) requires special expertise and behavior. Employees in an R&D department thus have unique attitudes, values, goals, and education that distinguish them from employees in manufacturing or sales departments.

A study by Paul Lawrence and Jay Lorsch examined three organizational departments—manufacturing, research, and sales—in 10 corporations.[47] This study found that each department evolved toward a different orientation and structure to deal with specialized parts of the external environment. Exhibit 4.4 illustrates the market, scientific, and manufacturing subenvironments identified by Lawrence and Lorsch. As shown in the exhibit, each department interacted with different external groups. The differences that evolved among departments within the organizations are shown in Exhibit 4.5. To work effectively with the scientific subenvironment, R&D had a goal of quality work, a long time horizon (up to five years), an informal structure, and task-oriented employees. Sales was at the opposite extreme. It had a goal of customer satisfaction, was oriented toward the short term (two weeks or so), had a very formal structure, and was socially oriented.

One outcome of high differentiation is that coordination and collaboration among departments become difficult. More time and resources must be devoted to achieving coordination when attitudes, goals, and work orientation differ so widely. **Integration** is the quality of collaboration among departments.[48] Formal

EXHIBIT 4.4
Organizational Departments Differentiate to Meet Needs of Subenvironments

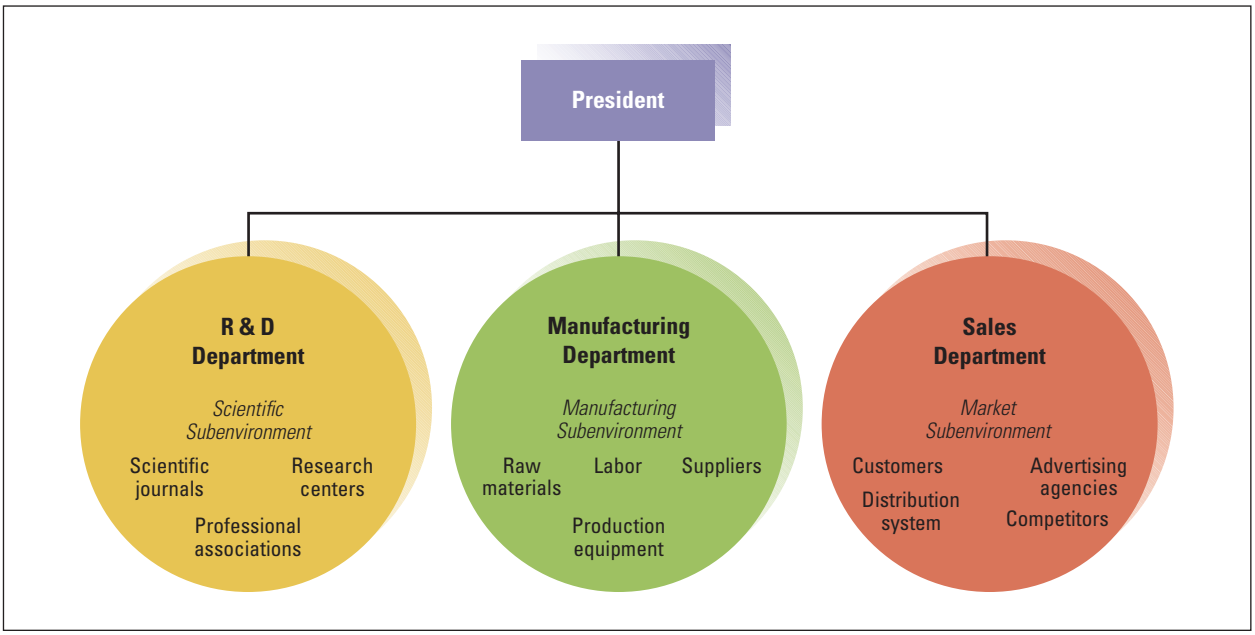

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EXHIBIT 4.5
Differences in Goals and Orientations Among Organizational Departments

Characteristic	R&D Department	Manufacturing Department	Sales Department
Goals	New developments, quality	Efficient production	Customer satisfaction
Time horizon	Long	Short	Short
Interpersonal orientation	Mostly task	Task	Social
Formality of structure	Low	High	High

Source: Based on Paul R. Lawrence and Jay W. Lorsch, *Organization and Environment* (Homewood, IL: Irwin, 1969), 23–29.

integrators are often required to coordinate departments. When the environment is highly uncertain, frequent changes require more information processing to achieve horizontal coordination, so integrators become a necessary addition to the organization structure. Sometimes integrators are called liaison personnel, project managers, brand managers, or coordinators. As illustrated in Exhibit 4.6, organizations with highly uncertain environments and a highly differentiated structure assign about 22 percent of management personnel to integration activities, such as serving on committees, on task forces, or in liaison roles.[49] In organizations characterized by very simple, stable environments, almost no managers are assigned to integration roles. Exhibit 4.6 shows that as environmental uncertainty increases, so does differentiation among departments; hence, the organization must assign a larger percentage of managers to coordinating roles.

Lawrence and Lorsch's research concluded that organizations perform better when the levels of differentiation and integration match the level of uncertainty and complexity in the environment. Organizations that performed well in uncertain environments had high levels of both differentiation and integration, while those performing well in less uncertain environments had lower levels of differentiation and integration. A study of 266 modern manufacturing firms in nine countries confirmed that high levels of integration are associated with better performance in complex environments.[50]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Match internal organization structure to the external environment. If the external environment is complex, make the organization structure complex. Associate a stable environment with a mechanistic structure and an unstable environment with an organic structure. If the external environment is both complex and changing rapidly, make the organization highly differentiated and organic, and use mechanisms to achieve coordination across departments.

4.3d Organic Versus Mechanistic Management Processes

Recall our discussion of organic and mechanistic designs from Chapter 1. The degree of uncertainty in the external environment is one primary contingency that shapes whether an organization will function best with an organic or a mechanistic design. Tom Burns and G. M. Stalker observed 20 industrial firms in England and discovered that internal management processes were related to the external environment.[51] When the external environment was stable, the internal organization was characterized by standard rules, procedures, a clear hierarchy of authority, formalization, and centralization. Burns and Stalker called this a **mechanistic** organization system, as described in Chapter 1 and illustrated in Exhibit 1.7.

In rapidly changing environments, the internal organization was much looser, free-flowing, and adaptive, with a loose hierarchy and decentralized decision making.

Industry	Plastics	Foods	Container
Environmental uncertainty	High	Moderate	Low
Departmental differentiation	High	Moderate	Low
Percent management in integrating roles	22	17	0

Source: Based on Jay W. Lorsch and Paul R. Lawrence, "Environmental Factors and Organizational Integration," *Organizational Planning: Cases and Concepts* (Homewood, IL: Irwin and Dorsey, 1972), 45.

EXHIBIT 4.6
Environmental Uncertainty and Organizational Integrators

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Burns and Stalker used the term **organic** to characterize this type of organization. Complete the questionnaire in the "How Do You Fit the Design?" box for some insight into whether you are more suited to working in an organic organization or a mechanistic one.

As environmental uncertainty increases, organizations tend to become more organic, which means decentralizing authority and responsibility to lower levels, encouraging employees to take care of problems by working directly with one another, encouraging teamwork, and taking an informal approach to assigning tasks and responsibility. Thus, the organization is more fluid and is able to adapt continually to changes in the external environment.[52] Guiltless Gourmet, which sells low-fat tortilla chips and other high-quality snack foods, provides an example. When large companies like Frito Lay entered the low-fat snack-food market, Guiltless Gourmet shifted to a flexible virtual network structure to remain competitive. The company redesigned itself to become basically a full-time marketing organization, while production and other activities were outsourced. An 18,000-square-foot plant in Austin was closed, and the workforce was cut from 125 to about 10 core people who handle marketing and sales promotions. The flexible structure allowed Guiltless Gourmet to adapt quickly to changing market conditions.[53]

HOW DO YOU FIT THE DESIGN?

MIND AND ENVIRONMENT

Does your mind best fit an organization in a certain or an uncertain environment? Think back to how you thought or behaved as a student, as an employee, or in a formal or informal leader position. Please answer whether each of the following items was Mostly True or Mostly False for you.

	Mostly True	Mostly False
1. I always offered comments on my interpretation of data or issues.	____	____
2. I welcomed unusual viewpoints of others even if we were working under pressure.	____	____
3. I made it a point to attend industry trade shows and company (school) events.	____	____
4. I explicitly encouraged others to express opposing ideas and arguments.	____	____
5. I asked "dumb" questions.	____	____
6. I enjoyed hearing about new ideas even when working toward a deadline.	____	____
7. I expressed a controversial opinion to bosses and peers.	____	____
8. I suggested ways of improving my and others' ways of doing things.	____	____

Scoring: Give yourself one point for each item you marked as Mostly True. If you scored less than 5, your mindfulness level may be suited to an organization in a stable rather than unstable environment. A score of 5 or above suggests a higher level of mindfulness and a better fit for an organization in an uncertain environment.

Interpretation: In an organization in a highly uncertain environment everything seems to be changing. In that case, an important quality for a professional employee or manager is "mindfulness," which includes the qualities of being open-minded and an independent thinker. In a stable environment, an organization will be more "mechanistic," and a manager without mindfulness may perform okay because much work can be done in the traditional way. In an uncertain environment, everyone needs to facilitate new thinking, new ideas, and new ways of working. A high score on this exercise suggests higher mindfulness and a better fit with an "organic" organization in an uncertain environment.

Sources: These questions are based on ideas from R. L. Daft and R. M. Lengel, *Fusion Leadership*, Chapter 4 (San Francisco, CA: Berrett Koehler, 2000); B. Bass and B. Avolio, *Multifactor Leadership Questionnaire*, 2nd ed. (Menlo Park, CA: Mind Garden, Inc); and Karl E. Weick and Kathleen M. Sutcliffe, *Managing the Unexpected: Assuring High Performance in an Age of Complexity* (San Francisco, CA: Jossey-Bass, 2001).

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4.3e Planning, Forecasting, and Responsiveness

The whole point of increasing internal integration and shifting to a more organic design is to enhance the organization's ability to quickly respond to sudden changes in an uncertain environment. It might seem that in an environment where everything is changing all the time, planning is useless. However, in uncertain environments, planning and environmental forecasting actually become *more* important as a way to keep the organization geared for a coordinated, speedy response. When the environment is stable, the organization can concentrate on current operational problems and day-to-day efficiency. Long-range planning and forecasting are not needed because environmental demands in the future will be much the same as they are today.

With increasing environmental uncertainty, planning and forecasting become necessary.[54] Indeed, surveys of multinational corporations have found that as environments become more turbulent, managers increase their planning activities, particularly in terms of planning exercises that encourage learning, continual adaptation, and innovation.[55] For example, consider that following the September 11, 2001, terrorist attacks in the United States, there was a surge in the use of scenario and contingency planning as a way to manage uncertainty.

Recall from Chapter 2 that with scenario planning, managers mentally rehearse different scenarios based on anticipating various future changes that could affect the organization. Scenarios are like stories that offer alternative, vivid pictures of what the future will look like and how managers will respond. Royal Dutch/Shell Oil has long used scenario building and has been a leader in speedy response to massive changes that other organizations failed to perceive until it was too late.[56]

Planning can soften the adverse impact of external shifts. Organizations that have unstable environments often establish a separate planning department. In an unpredictable environment, planners scan environmental elements and analyze potential moves and countermoves by other organizations.

2 In a volatile, fast-changing environment, serious planning activities are a waste of time and resources.

ASSESS YOUR ANSWER

ANSWER: *Disagree.* General Colin Powell once said, "No battle plan survives contact with the enemy."[57] Yet no wise general would go into battle without one. Serious planning becomes more important in a turbulent environment, even though a plan will not last long. Planning and environmental forecasting help managers anticipate and be prepared to respond to changes. Lack of planning makes more sense in a stable, easily predictable environment.

Planning, however, cannot substitute for other actions, such as effective boundary spanning and adequate internal integration and coordination. The organizations that are most successful in uncertain environments are those that keep everyone in close touch with the environment so they can spot threats and opportunities, enabling the organization to respond immediately.

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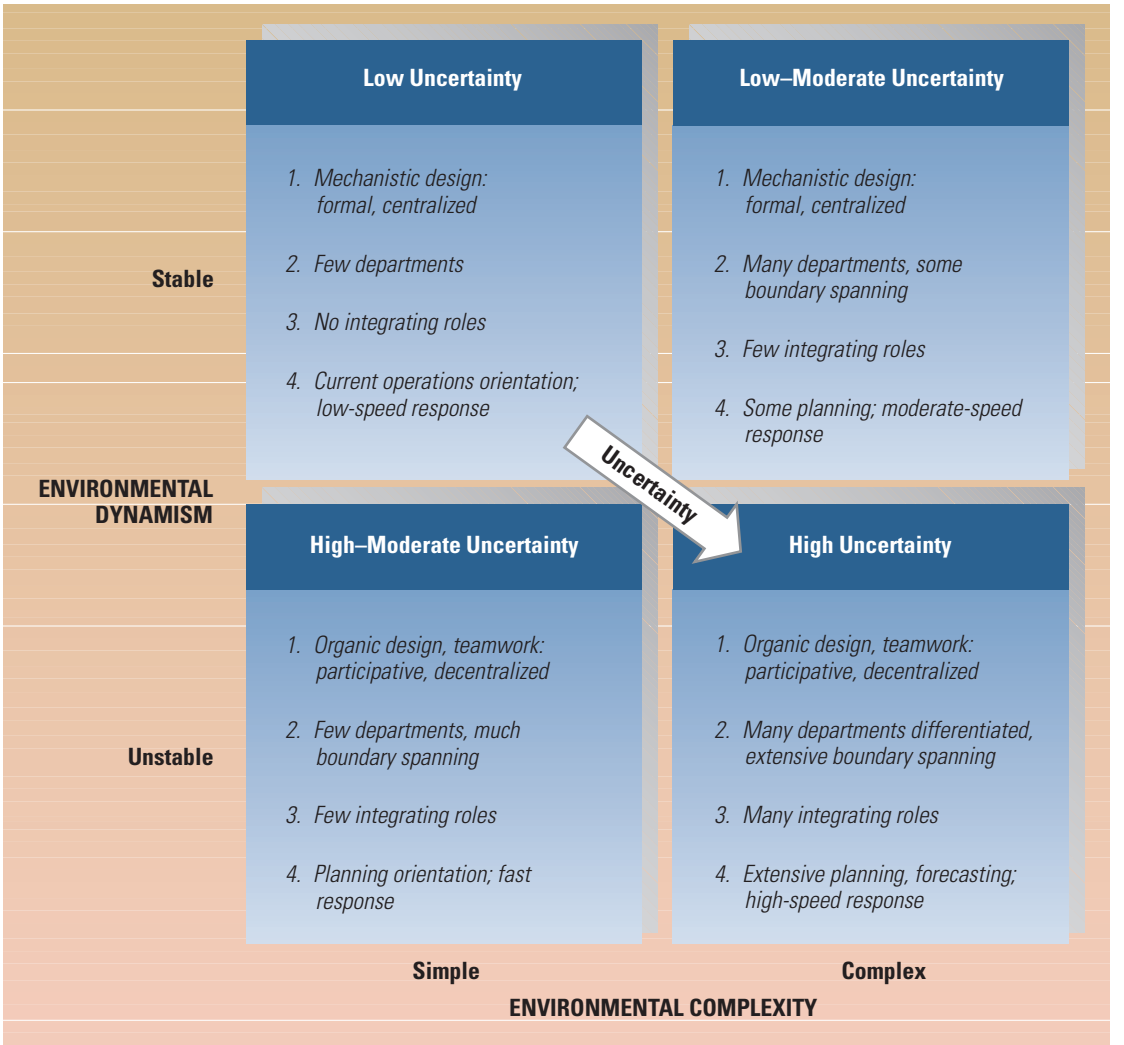
4.4 Framework for Adapting to Complexity and Dynamism

Exhibit 4.7 summarizes the ways in which environmental uncertainty influences organizational characteristics. The complexity and dynamism dimensions are combined and illustrate four levels of uncertainty. The low uncertainty environment is simple and stable. Organizations in this environment can have few departments and a mechanistic design. In a low–moderate uncertainty environment, more departments are needed, along with more integrating roles to coordinate the departments. Some planning may occur. Environments that are high–moderate uncertainty are simple but unstable. Organization design is organic and decentralized. Planning is emphasized, and managers are quick to make internal changes as needed.

EXHIBIT 4.7
Contingency Framework for Environmental Uncertainty and Organizational Responses



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The high uncertainty environment is both complex and unstable and is the most difficult environment from a management perspective. Organizations are large and have many departments, but they are also organic. A large number of management personnel are assigned to coordination and integration, and the organization uses boundary spanning, planning, and forecasting to enable a high-speed response to environmental changes.

REMEMBER THIS

- The more complex the environment, the greater differentiation within the organization. Differentiation means that departments become highly specialized to handle uncertainty in the part of the environment that the department works with.
- With high differentiation, managers must invest more time and resources to achieving coordination across departments.
- An organization that operates in a stable environment can function well with a mechanistic structure, but one that operates in a rapidly changing environment needs a more organic structure to perform well.
- Planning becomes more important in an uncertain environment.

4.5 Dependence on Financial Resources

Thus far, this chapter has described several ways in which organizations adapt to the lack of information and to the uncertainty caused by environmental dynamism and complexity. We turn now to the third characteristic of the organization–environment relationship that affects organizations, which is the abundance or scarcity of needed financial resources. A first response for many organizations faced with declining financial resources is to lay off employees and cut investments. In recent years, large oil companies such as Royal Dutch Shell, BP, and Chevron have significantly cut costs for finding and developing oil deposits due to declining crude oil prices. U.S. shale oil drillers have adapted to lower crude prices by pushing for reduced rates from suppliers of rigs, pipes, and other equipment and services, enabling the drillers to cut production costs by as much as 40 percent.[58]

Companies also strive to acquire control over financial resources to minimize their dependence on other organizations.[59] The environment is the source of scarce financial resources essential to organizational survival. Research in this area is called the *resource-dependence perspective*. **Resource dependence** means that organizations depend on the environment but strive to acquire control over resources to minimize their dependence. Organizations are vulnerable if vital financial resources are controlled by other organizations, so they try to be as independent as possible. Organizations do not want to become too vulnerable to other organizations because of negative effects on performance.

Although companies like to minimize their dependence, when costs and risks are high, they also team up to share scarce resources and be more competitive on a global basis. Formal relationships with other organizations present a dilemma to managers. Organizations seek to reduce vulnerability with respect to resources by

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developing links with other organizations, but they also like to maximize their own autonomy and independence. Organizational linkages require coordination,[60] and they reduce the freedom of each organization to make decisions without concern for the needs and goals of other organizations. Interorganizational relationships thus represent a trade-off between resources and autonomy. To maintain autonomy, organizations that already have abundant financial resources will tend not to establish new linkages. Organizations that need resources will give up independence to acquire those resources. For example, DHL, the express delivery unit of Germany's Deutsche Post AG, lost billions of dollars trying to take over the U.S. package delivery market and eventually entered into a partnership with UPS to have that company handle DHL parcels in the United States. The two organizations continue to compete in overseas markets. In the face of $3 billion in losses, difficulty building a local management team in the United States, and maintenance problems at U.S. package handling facilities, Deutsche Post's CEO Frank Appel called the partnership with UPS "a pragmatic and realistic strategy" for his company's U.S. operations.[61] Resource dependence will be discussed in more detail in Chapter 5.

4.6 Influencing Financial Resources

In response to the need for resources, organizations try to maintain a balance between depending on other organizations and preserving their own independence. Organizations maintain this balance through attempts to modify, manipulate, or control elements of the external environment (such as other organizations, government regulators) to meet their needs.[62] To survive, the focal organization often tries to reach out and change or control its environment. Two strategies can be adopted to influence resources in the external environment: establish favorable relationships with other organizations and shape the organization's environment.[63] Techniques to accomplish each of these strategies are summarized in Exhibit 4.8. As a general rule, when organizations sense that valued resources are scarce, they will use the strategies in Exhibit 4.8 rather than go it alone. Notice how dissimilar these strategies are from the responses to environmental dynamism and complexity described in Exhibit 4.7. The dissimilarity reflects the difference between responding to the need for resources and responding to the need for information.

4.6a Establishing Formal Relationships

Building formal relationships includes techniques such as acquiring ownership, establishing joint ventures and partnerships, developing connections with important people in the environment, recruiting key people, and using advertising and public relations.

EXHIBIT 4.8
Organizing Strategies for Controlling the External Environment

Establishing Formal Relationships	Influencing Key Sectors
1. Acquire an ownership stake	1. Change where you do business (your domain)
2. Form joint ventures and partnerships	2. Use political activity, regulation
3. Lock in key players	3. Join in trade associations
4. Recruit executives	4. Avoid illegitimate activities
5. Use advertising and public relations	

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Acquire an Ownership Stake. Companies use various forms of ownership to reduce uncertainty in an area important to the acquiring company. For example, a firm might buy a part of or a controlling interest in another company, giving it access to technology, products, or other resources it doesn't currently have.

A greater degree of ownership and control is obtained through acquisition or merger. An *acquisition* involves the purchase of one organization by another so that the buyer assumes control, such as when Target bought grocery delivery company Shipt, Google bought YouTube, eBay bought PayPal, and Walmart purchased the online clothing company ModCloth. A *merger* is the unification of two or more organizations into a single unit.[64] Sirius Satellite Radio and XM Satellite Radio Holdings merged to become Sirius XM Radio. The merger enabled the companies to combine resources and share risks to be more competitive against digital music providers and other emerging types of music distribution. In the past few years, there has been a huge wave of acquisition and merger activity in the telecommunications and advertising industries, reflecting how these companies cope with the tremendous uncertainty they face. Publicis and Omnicom have been acquiring smaller companies that can help the large firms adapt to the new world of digital advertising.

IN PRACTICE

Publicis and Omnicom

The marketing environment has become much more personalized in recent years, with companies wanting to send targeted ads directly to consumers' social media pages and smart phones. Advertising agencies are under pressure like never before. A few years ago, the giant advertising firms Omnicom and Publicis tried to negotiate a "merger of equals" to better compete in a rapidly shifting environment in which companies such as Google and Microsoft worked directly with companies to create targeted ad campaigns. Within a year, they announced that the proposed $35 billion merger was off. Instead, both firms started buying up smaller companies that would bring digital technology experts on board. Publicis, for example, bought Sapient, an information-technology consulting firm, and digital marketing specialists Digitas Inc. and Razorfish.

However, getting digital technology people and traditional creative types to work together has been a challenge, reflecting the need for greater integration, as described earlier in this chapter. Creative people used to call the shots, but today advertising and marketing is "big data" business. That was brought home to Publicis when McDonald's wanted a new broad marketing plan that required analyzing massive amounts of data to produce online ads quickly and target specific messages to very narrow audiences. When Publicis got a team of copywriters, art directors, and computer engineers together to talk about the campaign, team members couldn't even agree on the meaning of basic terms such as "data" and "content," one participant said. Publicis lost the account to rival Omnicom, which had worked closely with Facebook and Google to assemble the right mix of creative talent and data experts.[65]

Form Joint Ventures and Partnerships. When there is a high level of complementarity between the business lines, geographical positions, or skills of two companies, the firms often go the route of a strategic alliance rather than ownership through merger or acquisition.[66] Such alliances are formed through contracts and joint ventures.

Contracts and joint ventures reduce uncertainty through a legal and binding relationship with another firm. Contracts come in the form of *license agreements* that involve the purchase of the right to use an asset (such as a new technology) for a specific time and *supplier arrangements* that contract for the sale of one firm's

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output to another. Contracts can provide long-term security by tying customers and suppliers to specific amounts and prices. For example, the Italian fashion house Versace forged a deal to license its primary asset—its name—for a line of designer eyeglasses.[67]

Joint ventures result in the creation of a new organization that is formally independent of the parents, although the parents will have some control.[68] Madrid-based tech start-up FON formed a joint venture with British phone carrier BT to install FON wi-fi technology in the modems of nearly 2 million BT customers. Office Depot and Reliance Retail Limited, a division of India's largest private-sector employer, entered into a joint venture to provide office products and services to business customers in India. Food and agricultural corporation Cargill Inc. has numerous joint ventures around the world, such as the one with Spanish cooperative Hojiblanca to source, trade, and supply customers worldwide with private label and bulk olive oils. As evidenced by these short examples, many joint ventures are undertaken to share risks when companies are doing business in other countries or on a global scale.

Lock in Key Players. **Cooptation** occurs when leaders from important sectors in the environment are made part of an organization. It takes place, for example, when influential customers or suppliers are appointed to the board of directors, such as when the senior executive of a bank sits on the board of a manufacturing company. As a board member, the banker may become psychologically coopted into the interests of the manufacturing firm.

An **interlocking directorate** is a formal linkage that occurs when a member of the board of directors of one company sits on the board of directors of another company. The individual is a communications link between companies and can influence policies and decisions. When one individual is the link between two companies, this is typically referred to as a **direct interlock.** An **indirect interlock** occurs when a director of company A and a director of company B are both directors of company C. They have access to one another but do not have direct influence over their respective companies.[69] Research shows that, as a firm's financial fortunes decline, direct interlocks with financial institutions increase. Financial uncertainty facing an industry also has been associated with greater indirect interlocks between competing companies.[70]

Important business or community leaders also can be appointed to other organizational committees or task forces. By serving on committees or advisory panels, these influential people learn about the needs of the company and are more likely to consider the company's interests in their decision making. Today, many companies face uncertainty from environmental pressure groups, so organizations are trying to bring in leaders from this sector, such as when DuPont appointed environmentalists to its biotechnology advisory panel.[71]

Recruit Executives. Transferring or exchanging executives also offers a method of establishing favorable linkages with external organizations. For example, the aerospace industry often hires retired generals and executives from the Department of Defense. These generals have personal friends in the department, so the aerospace companies obtain better information about technical specifications, prices, and dates for new weapons systems. They can learn the needs of the defense department and are able to present their case for defense contracts in a more effective way. Companies without personal contacts find it nearly impossible to get a defense contract. Having channels of influence and communication between organizations reduces financial uncertainty and dependence for an organization.

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Get Your Side of the Story Out. A traditional way of establishing favorable relationships is through advertising. Organizations spend large amounts of money to influence the tastes and opinions of consumers. Advertising is especially important in highly competitive industries and in industries that experience variable demand. For example, since the U.S. Food and Drug Administration loosened regulations on the advertising of prescription drugs in the United States, spending by the major pharmaceutical companies has zoomed. A recent report indicates that advertising of prescription drugs directly to consumers went from $1.3 billion in 1997 to $6 billion in 2016.[72]

Public relations is similar to advertising, except that stories often are free and aimed at public opinion. Public relations people cast an organization in a favorable light in speeches, on websites, in press reports, and on television. Public relations attempts to shape the company's image in the minds of customers, suppliers, government officials, and the broader public. Google is a master at shaping its image through donations, fellowship programs, and at conferences that establish a network of ties to advocacy organizations, public intellectuals, and academic institutions that often take Google's side in public debates and national policy issues. By encouraging and sometimes supporting groups that hold viewpoints similar to its own, Google has an ongoing widespread PR campaign that one reporter referred to as "subtle acts of persuasion."[73] Blogging, tweeting, and social networking have become important components of public relations activities for many companies today.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Reach out and control external sectors that threaten needed resources. Influence the domain by engaging in political activity, joining trade associations, and establishing favorable relationships. Establish relationships through ownership, joint ventures and strategic partnerships, cooptation, interlocking directorates, and executive recruitment. Reduce the amount of change or threat from the external environment so the organization will not have to change internally.

4.6b Influencing Key Sectors

In addition to establishing favorable linkages, organizations often try to change the environment. There are four techniques for influencing or changing a firm's environment.

Change Where You Do Business. Early in this chapter, we talked about the organization's *domain* and the 11 sectors of the environment. An organization's domain is not fixed. Managers make decisions about which business to be in; the markets to enter; and the suppliers, banks, employees, and location to use; and this domain can be changed, if necessary, to keep the organization competitive.[74] An organization can seek new environmental relationships and drop old ones. Walmart, which long focused on its big box retail stores, now has a strong e-commerce business, while Amazon is trying to build a physical presence across the nation.

IN PRACTICE

Amazon and Walmart

Walmart is still playing catch-up to Amazon online, but the country's largest brick-and-mortar retailer also now has a thriving online business. In addition to its regular business, Walmart has recently been buying up small, unique online retailers such as ModCloth, ShoeBuy, and Moosejaw that can help the company appeal to more customers. Walmart plans to let the companies operate as separate entities.

At the same time, Amazon, the giant of e-commerce, is building convenience stores, warehouses, pickup locations, and even grocery stores across the country that will invade Walmart's turf. Amazon has decided it wants to control *all* shopping, not just online shopping. To remain competitive, Walmart had to learn the rules of the technology business from the ground up. It acquired a number of companies that could build tools to crunch data, create mobile apps, and speed up websites. Managers at the two giants are now shifting their domains so that Walmart is becoming more technology oriented and Amazon is competing more in physical space. Both companies believe the future is a combination of stores and online.[75]

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Walmart managers knew they needed to alter the domain to be more competitive against Amazon as shopping habits continue to shift more toward online. Managers have many reasons for altering an organization's domain. They may try to find a domain where there is little competition, no government regulation, abundant suppliers, affluent customers, and barriers to keep competitors out. Acquisition and divestment are two techniques for altering the domain. For example, Google acquired YouTube to expand its domain beyond search, and Facebook paid $16 billion for WhatsApp, a text-messaging application with 450 million users. An example of divestment was when Google sold the Motorola Mobility smartphone unit to Lenovo for $2.9 billion to get out of the business of manufacturing phones.[76]

Get Political. Political activity includes techniques to influence government legislation and regulation. Political strategy can be used to erect regulatory barriers against new competitors or to squash unfavorable legislation. Corporations also try to influence the appointment to agencies of people who are sympathetic to their needs. As one example of political activity, the American Hotel and Lodging Association, which counts some of the largest hotel chains among its members, has quietly but forcefully lobbied local, state, and federal officials to rein in Airbnb. The group has been able to get bills signed to impose steep fines on Airbnb hosts who break local housing rules, for instance. Airbnb is a significant threat to the hotel industry, so its trade group has implemented a long-term "multipronged, national campaign" to fight back.[77]

Many CEOs believe they should participate directly in lobbying. CEOs have easier access than lobbyists and can be especially effective when they do the politicking. Political activity is so important that "informal lobbyist" is an unwritten part of almost any CEO's job description.[78]

ASSESS YOUR ANSWER

3 Managers of business organizations should not get involved in political activities.

ANSWER: *Disagree.* Smart business managers get involved in lobbying and other political activities to try to make sure the consequences of new laws and regulations are mostly positive for their own firms. Companies pay huge fees to associations and lobbyists to make sure government actions work out in their favor.

Unite with Others. Much of the work to influence the external environment is accomplished jointly with other organizations that have similar interests. For example, most large pharmaceutical companies belong to Pharmaceutical Research and Manufacturers of America. Manufacturing companies are part of the National Association of Manufacturers, and retailers join the Retail Industry Leaders Association. The American Petroleum Institute is the leading trade group for oil and gas companies. By pooling resources, these organizations can pay people to carry out activities such as lobbying legislators, influencing new regulations, developing public relations campaigns, and making campaign contributions. Primerica, based in a suburb of Atlanta, is using the resources and influence of the American Council of Life Insurers to push for changes in state licensing exams, which the company believes put minorities at a disadvantage. Primerica, unlike most large insurance companies, focuses on selling basic term life insurance

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and depends almost exclusively on middle-income consumers rather than selling pricier policies. Company managers say the way the test questions are phrased limits their ability to expand their corps of minority agents that could better serve minority communities.[79]

Don't Fall into Illegitimate Activities. Illegitimate activities represent the final technique companies sometimes use to control their environmental domain, but this technique typically backfires. Conditions such as low profits, pressure from senior managers, or scarce environmental resources may lead managers to adopt behaviors not considered legitimate.[80] One study found that companies in industries with low demand, shortages, and strikes were more likely to be convicted for illegal activities, suggesting that illegal acts are an attempt to cope with resource scarcity. Some nonprofit organizations have been found to use illegitimate or illegal actions to bolster their visibility and reputation as they compete with other organizations for scarce grants and donations, for example.[81]

Bribery is one of the most frequent types of illegitimate activity, particularly in companies operating globally. Energy companies face tremendous uncertainty, for example, and need foreign governments to approve giant investments and authorize risky projects. Under pressure to win contracts in Nigeria, Albert "Jack" Stanley, a former executive at KBR (then a division of Halliburton Company), admits he orchestrated a total of about $182 million in bribes to get Nigerian officials to approve the construction of a liquefied natural gas plant in that country. Stanley was sentenced to 30 months in prison and a hefty fine after pleading guilty.[82] Other types of illegitimate activities include payoffs to foreign governments, illegal political contributions, promotional gifts, and price-fixing. For nearly a decade, executives from Procter & Gamble (P&G), Colgate-Palmolive, Unilever, and Henkel AG secretly met in restaurants around Paris to allegedly fix the price of laundry detergent in France. The managers used fake names and discussed elaborate and complex pricing mechanisms in meetings that sometimes lasted as long as four hours. The scheme went on for years until members had a disagreement over price increases and promotions and one member handed over a 282-page report to French antitrust authorities. The companies involved were eventually fined a total of €361 ($484 million).[83]

REMEMBER THIS

- The third characteristic of the organization–environment relationship is the abundance or scarcity of financial resources needed by the organization.
- Resource dependence means that organizations depend on the environment but strive to acquire control over resources to minimize their dependence.
- When risk is great or resources are scarce, the organization can establish linkages through acquisitions, joint ventures and alliances, interlocking directorates, executive recruitment, or advertising and public relations that will minimize risk and maintain a supply of scarce resources.
- Other techniques for influencing the environment include a change of the domain in which the organization operates, political activity, participation in trade associations, and perhaps illegitimate activities.

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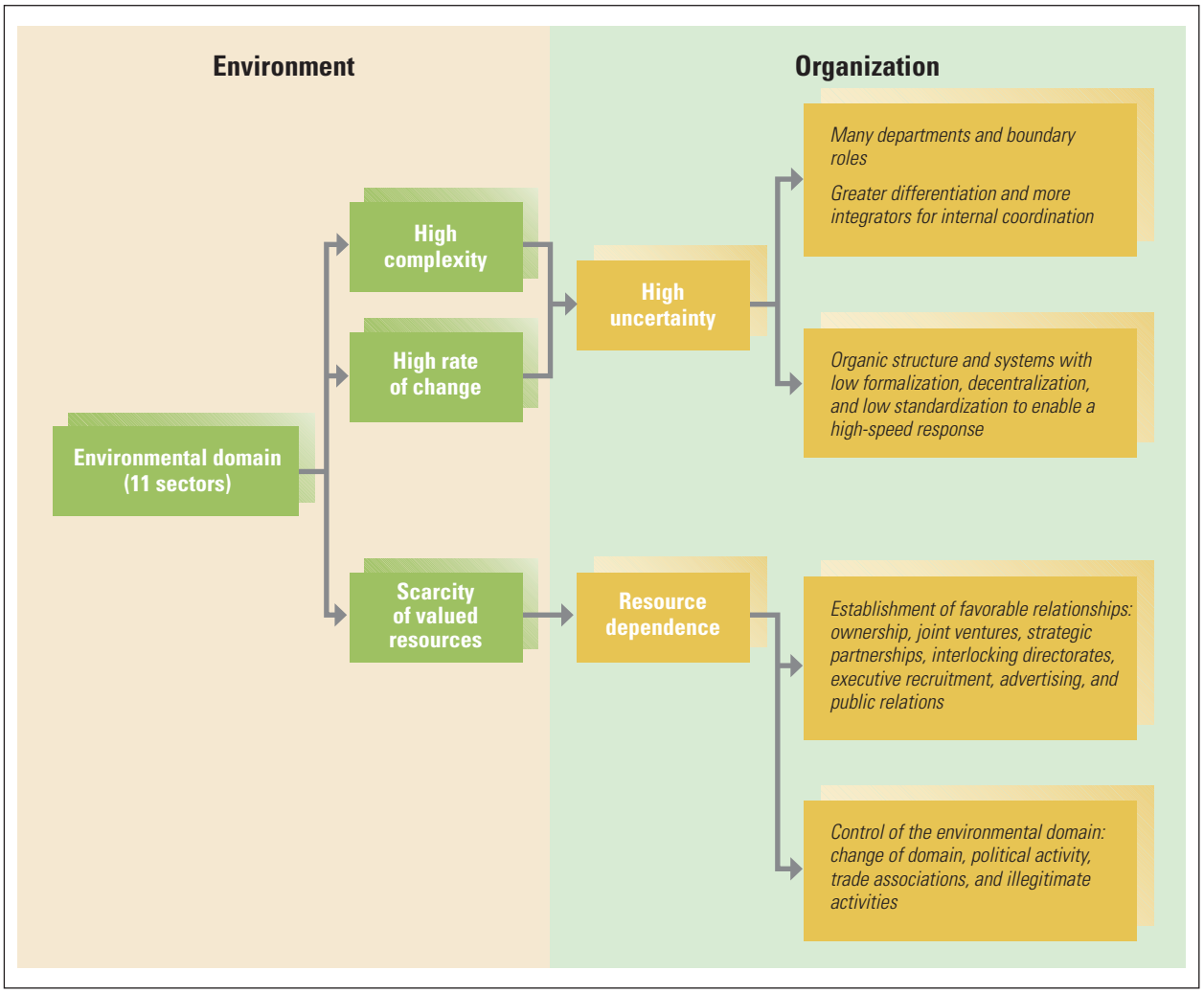
4.7 Organization–Environment Integrative Framework

The relationships illustrated in Exhibit 4.9 summarize the two major themes about organization–environment relationships discussed in this chapter. One theme is that the amount of complexity and dynamism in an organization's domain influences the need for information and hence the uncertainty felt within an organization. Greater information uncertainty is resolved through greater structural flexibility (an organic design) and the assignment of additional departments and boundary roles. When uncertainty is low, management structures can be more mechanistic, and the number of departments and boundary roles can be fewer. The second theme pertains to the scarcity of financial resources. The more dependent an organization is on other organizations for those resources, the more important it is to either establish favorable linkages with those organizations or control entry into the domain. If dependence on external resources is low, the organization can maintain autonomy and does not need to establish linkages or control the external domain.

EXHIBIT 4.9
Relationship Between Environmental Characteristics and Organizational Actions


Environment
Organization
Environmental domain (11 sectors)
High complexity
High rate of change
Scarcity of valued resources
High uncertainty
Resource dependence
Many departments and boundary roles
Greater differentiation and more integrators for internal coordination
Organic structure and systems with low formalization, decentralization, and low standardization to enable a high-speed response
Establishment of favorable relationships: ownership, joint ventures, strategic partnerships, interlocking directorates, executive recruitment, advertising, and public relations
Control of the environmental domain: change of domain, political activity, trade associations, and illegitimate activities

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REMEMBER THIS

- Systematic patterns exist in the relationship between an organization and its external environment. The elements of environmental dynamism, complexity, and resource scarcity have predictable consequences for an organization and its response.
- Two key themes in this chapter are that organizations can learn and adjust to the environment and conversely that organizations can influence outward to change and control the environment. These strategies are especially true for large organizations that command many resources. These organizations can adapt when necessary but can also neutralize or change problematic areas in the environment.

KEY CONCEPTS

boundary-spanning roles
buffering roles
business intelligence
complexity
cooptation
differentiation
direct interlock
domain
dynamism
general environment
indirect interlock
integration
intelligence team
interlocking directorate
mechanistic
organic
organizational environment
resource dependence
sectors
task environment
uncertainty

DISCUSSION QUESTIONS

1. How would the task environment of a new Internet-based company compare to that of a large government agency? Discuss.
2. Which typically has the greatest impact on organizational uncertainty—environmental complexity or environmental dynamism? Why?
3. Name some factors causing environmental complexity for a local organization of your choice, such as a restaurant or sporting goods store. How might this environmental complexity lead to organizational complexity? Explain.
4. Discuss the importance of the international sector for an organization today compared to domestic sectors. What are some ways in which the international sector affects organizations in your city or community?
5. Describe differentiation and integration. In what type of environmental uncertainty do you think differentiation and integration would be greatest? Least?
6. Do you think planning becomes more important or less important in a world where everything is changing fast and crises are a regular part of organizational life? Why?
7. Compare an organic organization to a mechanistic organization. How does the environment influence organic and mechanistic designs?
8. Why do organizations become involved in interorganizational relationships? Do these relationships affect an organization's dependency? Explain.
9. Assume you have been asked to calculate the ratio of staff employees to production employees in two organizations—one in a simple, stable environment and one in a complex, shifting environment. How would you expect these ratios to differ? Why?
10. Is changing the organization's domain a feasible strategy for coping with a changing environment? Explain, using either Amazon or Walmart as an example.

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CHAPTER 4 WORKSHOP Organizations You Rely On[84]

Below, list four organizations you somehow rely on in your daily life for some resource. Examples might be a restaurant, a clothing store, a university, your family, the post office, your wireless provider, an airline, a pizzeria that delivers, and your place of work. In the first column, list those four organizations. Then, in column 2, choose another organization you could use in case the one in column 1 was not available. In column 3, evaluate your level of dependence on the organizations listed in column 1 as Strong, Medium, or Weak. Finally, in column 4, rate the certainty of that organization being able to meet your needs as High (certainty), Medium, or Low.

Organization	Backup Organization	Level of Dependence	Level of Certainty
1.			
2.			
3.			
4.			

Questions

1. Do you have adequate backup organizations for those of high resource dependence? How might you create even more backups?
2. What would you do if an organization you rated high for dependence and high for certainty suddenly became high dependence and low certainty? How would your behavior relate to the concept of resource dependence?
3. Have you ever used any behaviors similar to those in Exhibit 4.8 to manage your relationships with the organizations listed in column 1?

CASE FOR ANALYSIS | CPI Corporation[85]

They are the most treasured possessions; they line mantels and living room walls; they are the first items frantically sought by family members following fires or natural disasters. They are family photographs.

Considering the popularity and demand for beloved photographs, it seems logical that the market leader in the portrait studio industry, with a 60-year history of success and the convenience of store locations within retail giants Walmart, Sears, and BabiesRUs, would have the confidence of a secure and bright future. That was the apparent situation for CPI Corporation, the store-within-a-store portrait studios. With over 1,500 locations, the studios offered consumers the convenience of inexpensive family portrait packages, combined with one-stop shopping for family and household needs.

Then abruptly, in April 2013, CPI announced closure of all of the company's U.S. locations. That announcement and immediate slamming of the doors caught everyone,

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including employees and customers, by surprise. As families scrambled to locate and retrieve their photographs, employees absorbed the blow of a sudden loss of salary and benefits, including health insurance.

But in recent years, there had been voices of concern and questions about the direction of CPI. At a board meeting a few years earlier in St. Louis, then-CEO Paul Rasmussen expressed concerns with the need for improvement of the customer in-store experience and his own awareness of the lengthy wait times for photo sessions, even when customers had an appointment, followed by additional lengthy wait times (up to six weeks) for delivery of the photos from a central printing location. Rasmussen proposed changes to the in-studio process, but the board of directors was not interested. The board was not listening to the consumer.

The abruptness of the closures may have been the only real surprise to many competitors who continued to thrive and who expressed amazement that the industry leader failed to blaze the way with cutting-edge technology.

"There's no reason why CPI didn't invent Instagram (photo sharing)," said Mitch Goldstone, CEO of ScanMyPhotos.com. "CPI had the greatest opportunity. They had a huge customer base nationwide that they let disappear overnight."

Aware of its corporate strengths, CPI increasingly failed to read and respond to the changing environment in which it conducted business. A glance through its recent history reveals potential problem areas for the company. Rasmussen's 2006 urging to board members to shorten in-store wait times and to modernize backdrops and traditional posing styles was ignored in favor of finding ways to attract additional customers into the studio, where they would experience the same slow process. Consumer expectations were changing toward the immediate gratification enabled by the iPhone age with digital photography and instant access/sharing capabilities for their photographs. CPI, however, remained committed to centralization of printing and avoided the cost of updating stores with digital technology. Meanwhile, competitors discovered innovative ways to build technology into their services and products. Companies such as Picture Perfect offered one-hour digital printing. ScanMyPhotos.com provided the convenience of online photo services. And Lifetouch, whose store-within-a-store photo studios are located in JCPenney and Target stores, expanded their market into providing school pictures.

As technological trends, consumer behaviors, and attitudes changed, CPI continued holding on to its own success model. In April 2013, with loan obligations of $98.5 million that it could not pay, CPI closed all U.S. locations. By June, competitor Lifetouch Portrait Studios, Inc. had entered a "stalking horse" agreement to purchase all CPI assets and awaited competing offers.

Photography and digital technology continue to evolve at an unimaginable pace, and consumers feel empowered in their abilities to now go beyond taking, sharing, and printing photographs to explore the design and manipulation and animation of photographs.

Questions

1. Why do you think CPI board members held onto the company's success model and did not respond to the environmental changes in photo technology and customer desires?
2. What type of organization structure and management process did CPI appear to have and what type of structure would have been better suited to its changing environment? Explain.
3. As business competitors in the industry weigh their future, how might they pay attention and adjust their business strategies to remain viable and avoid the CPI fate? Discuss.

CASE FOR ANALYSIS | Farrington Medical Devices

Benjamin and William Farrington started a small manufacturing business with their father, Samuel Farrington, who was a professor of biomedical science at a major university. They began the business by making a line of smaller and more precise non-reusable cardiac catheters, used to diagnose and treat heart conditions. They soon added a line of new style intra-aortic balloon pumps that the father designed to help a healing heart pump blood.

Three years after starting the business, just when sales started to grow rapidly, Samuel Farrington passed away. The family was devastated, but the brothers had graduate degrees in biology and engineering and felt confident about moving forward with the business on their own. Benjamin would take charge of catheters, which had a separate production line. William would be in charge of the balloon pump line. They would share the engineering, product development, purchasing, and sales and marketing functions. There was only one big problem. The brothers had almost opposite leadership styles. They were in frequent conflict about how to treat employees and create the type of culture that was best for Farrington.

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William, the younger brother, was very people-oriented. He liked to work with people in teams. He encouraged people to work together. He emphasized the need for collaborative decision making. He would organize meetings to discuss departmental objectives and deadlines. He often asked people's opinions and ideas about their work, both in meetings and with individuals during his daily activities. If someone had a piece of information useful for others, he would call a meeting to share this information with a broader group. William encouraged people to exchange information and help each other as the need arose.

Benjamin, the older brother, was concerned more about providing clear structure for employees and achieving efficiency, which did not include unnecessary meetings that, in his opinion, would waste people's time. When Benjamin felt the need for a meeting, he would take charge and give instructions, so employee participation was limited. He took pride in assigning tasks and determining performance goals and deadlines. There was little opportunity for employees to suggest ideas, and they worked under pressure to reach their assigned performance goals. Benjamin preferred that people stay occupied with their respective tasks and saw no need for employees to help each other.

Employees were confused by the opposite management approaches at Farrington. As time passed the brothers seemed in constant conflict with one another. Their dissatisfaction with each other was high. Each believed his own approach was a superior way to run the business. Finally, after both brothers grew tired of the conflicts and neither would give in to the other's style, the brothers reluctantly decided to split the business into two separate businesses, each with a new name. Benjamin took the more established cardiac catheters production to a new location and renamed his business Caresource Cardiac, Inc. William stayed in the current location and renamed his intra-aortic balloon pump business Quest Medical Devices. The brothers were now in competition and were using very different approaches to managing their businesses.

The broader industry competition in the medical devices business was intense, with large companies introducing new products and frequently trying to gain an edge by reducing prices. The Farrington brothers were initially ahead of their competition because of their father's product innovations. However, over a few years, competitors caught up and both brothers' businesses needed to keep innovating to stay ahead.

Benjamin created a management structure with three levels between himself and line employees. He liked this structure because managers could keep a close eye on direct reports. Benjamin took a top-down approach to any changes in how tasks were performed or for implementing product innovations and process improvements. He kept close tabs on costs and efficiency with a weekly meeting to assess production and sales efficiency. Caresource also had carefully drawn organization charts along with job descriptions and written procedures. Benjamin believed everyone should have clear responsibilities and narrowly defined jobs to ensure efficient performance and high profits.

William wanted to maintain a small-company culture that minimized status differences among executives, managers, and employees. His focus seemed more on employee happiness than on production efficiency. Everyone was on a first name basis. There were two layers of management between line employees and himself. He was not a fan of organization charts and job descriptions. He wanted everyone to feel a part of the organization. Ideas for process improvements or product changes could arise from anyone. William created a performance excellence committee made up of employees who met monthly to discuss and resolve issues that affected operational performance. This committee handled issues such as late deliveries from suppliers and quality issues or delays in production. Production employees were cross-trained in different jobs to produce and assemble the complex aortic balloon pumps.

Although the brothers started with separate businesses, each company gradually broadened its product line, including the manufacture of products produced by the other. After 12 years, the two businesses were in direct competition. As both businesses succeeded, the brothers became friendly again, but they still saw each other as running a competing business.

A huge competitor in the industry, Johnston Medical Care, decided to outsource the manufacture of a new ventricular assist device to a smaller company rather than manufacture the device at its own facility. Caresource and Quest would be competing for the profitable contract that could amount to as much as $100 million.

This was a rush order to produce a prototype to meet a three-month deadline. At Caresource, Benjamin told the engineering, product development, production, and purchasing departments to begin working on the ventricular device design from their own perspective. Benjamin communicated to all department heads about the critical time constraints and that he expected all employees to perform efficiently as they had in the past. The departments had little contact with one another for several days as they developed their own requirements at their own speed. Problems arose. Purchasing learned that one likely needed material could not be acquired on time. Engineering had difficulty arranging an efficient production sequence. Product development was dealing with blueprint specs different from their expertise. Benjamin learned that both engineering and product development were falling behind schedule on their development work. He reacted angrily and decided

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to push ahead and assemble one prototype without a key part made from the scarce material that would have to be inserted at the last minute.

At Quest the prints from Johnston arrived and the department heads met together to discuss the project. Engineering, product development, and manufacturing worked together to design product features. As with Caresource, one needed material could not be delivered on time, so the assembly sequence was difficult to engineer. The departments exchanged ideas, and key employees held daily meetings to discuss progress and help each other. One employee knew of an Australian source for the missing material, so that problem would be resolved by the deadline. Moreover, while employees were building the prototype, a draftsperson in the engineering department discovered an error in the original print specifications from Johnston. All the engineers agreed after checking and rechecking the blueprints that a design error existed. They spent most of the night redesigning the original specifications and finalized the changes the next morning. William contacted the head designer at Johnston, who confirmed the error and said to proceed with the design changes. Johnston also notified Benjamin at Caresource about the blueprint error.

Both companies produced 50 prototype units of the ventricular assist device for inspection by Johnston. Caresource missed the deadline by nine days. Ten of the Caresource units were defective, and none of the Quest units failed inspection. Caresource's bid for the production of the device was ten percent lower than Quest's bid. Johnston Medical decided to split the order equally between the two companies to learn which would produce the new product more effectively.

Questions

1. How would you describe the management processes within Caresource versus Quest? Which seemed more effective? Why?
2. Which organizational design (Caresource or Quest) do you think was more appropriate for a competitive and changing technological environment? Why?
3. In your opinion, which firm should have won the complete contract—Caresource or Quest? Which do you think eventually will be chosen to produce the ventricular device? Explain.

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CHAPTER

5 Interorganizational Relationships

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Learning Objectives

After reading this chapter you should be able to:

1. Describe an organizational ecosystem and the changing role of management in interorganizational relationships.
2. Identify types of resource-dependence relationships and their power implications.
3. Explain the role of collaborative networks and the interorganizational shift from adversaries to partners.
4. Describe key concepts of the population-ecology perspective, including organizational form and niche and the process of change.
5. Compare three mechanisms that lead to institutional similarity identified by the institutional view of organizations.

Chapter Outline

Organizational Ecosystems

Is Competition Dead? • The Changing Role of Management • Interorganizational Framework

Resource Dependence

Types of Resource-Dependence Relationships • Power Implications

Collaborative Networks

Why Collaboration? • From Adversaries to Partners

Population Ecology

What Hinders Adaptation? • Organizational Form and Niche • Process of Ecological Change • Strategies for Survival

Institutionalism

The Institutional View and Organization Design • Institutional Similarity

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **Organizations should strive to be as independent and self-sufficient as possible so that their managers aren't put in the position of "dancing to someone else's tune."**

I AGREE _____ **I DISAGREE** _____

2 **The success or failure of a startup is largely determined by the smarts and management ability of the entrepreneur.**

I AGREE _____ **I DISAGREE** _____

3 **Managers should quickly copy or borrow techniques being used by other successful companies to make their own organization more effective and to keep pace with changing times.**

I AGREE _____ **I DISAGREE** _____

Great news! U.S. manufacturing has been booming in recent years, with industrial companies reporting strong sales and profits and an increase in factory hiring. Now here's the bad news. Some of those companies have had to shut down production lines and absorb higher costs because suppliers of everything from engines to electronic components have not been keeping up with the increase in demand. Oshkosh Corporation halted production of its mobile cranes several times in one recent quarter because the company could not get the parts it needed. Machinery maker Caterpillar has had to pay higher prices for parts, even accepting incomplete orders, to keep production going. Managers at Leggett & Platt, which makes parts for forklifts, say they're paying employees more in overtime to expand production and are considering more permanent ways to increase capacity. Manufacturers that spent years making their supply chains as lean and efficient as possible are paying the price now, with suppliers hesitant "to jump on adding capacity because they've been burned badly before," says Shiv Shivaraman, a consultant who advises auto and machinery makers on supply chains and production processes.[1]

Having the parts and supplies when they are needed is a concern for every organization, and companies often establish personal relationships with key suppliers to make sure they'll have the resources they need. Supply chain and partnership relationships are highly important, because organizations join together and depend on one another in a variety of ways. Consider the turmoil in the healthcare industry. Medical costs and health insurance rates continue to rise, and large health insurance companies have been slow to find innovative solutions to inefficiencies in the system. Three of the largest and most influential companies in the United States—Amazon, Berkshire Hathaway, and JPMorgan Chase—recently joined together to form an independent healthcare company to serve their 1.2 million employees. Leaders say the goal of the non-profit organization, named Haven, is to change the way their employees experience healthcare so that it is simpler, better, more efficient, and lower cost.[2]

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Today's organizations encounter numerous complex problems because of the complexity and uncertainty of the environment, as discussed in the previous chapter. Thus, a widespread organizational trend is to reduce separation and increase collaboration between companies, sometimes even between competitors. Apple and Google compete fiercely in some areas, but they teamed up for Apple to use the Google Cloud platform as part of the infrastructure for Apple's iCloud storage service.[3]

In many industries, the business environment is so complicated that no single company can develop all the expertise and resources needed to stay competitive. Why? Globalization and rapid advances in technology, communications, and transportation have created amazing new opportunities, but they have also raised the cost of doing business and made it increasingly difficult for any company to take advantage of those opportunities on its own. In this new economy, webs of organizations are emerging. Collaboration and partnership is the new way of doing business. Organizations think of themselves as teams that create value jointly rather than as autonomous companies that are in competition with all others.

Purpose of This Chapter

This chapter explores the most recent trend in organizing, which is the increasingly dense web of relationships among organizations. Companies have always been dependent on other organizations for supplies, materials, and information. The question involves the way these relationships are managed. At one time it was a matter of a large, powerful company tightening the screws on small suppliers. Today a company can choose to develop positive, trusting relationships. The notion of horizontal relationships described in Chapter 3 and the understanding of environmental uncertainty in Chapter 4 are leading to the next stage of organizational evolution, which is a web of horizontal relationships *across* organizations. Organizations can choose to build relationships in many ways, such as appointing preferred suppliers, establishing agreements, business partnering, joint ventures, or even mergers and acquisitions.

Interorganizational research has yielded perspectives such as resource dependence, collaborative networks, population ecology, and institutionalism. The sum total of these ideas can be daunting because it means managers no longer can rest in the safety of managing a single organization. They have to figure out how to manage a whole set of interorganizational relationships, which is a great deal more challenging and complex.

5.1 Organizational Ecosystems

Interorganizational relationships are the relatively enduring resource transactions, flows, and linkages that occur among two or more organizations.[4] Traditionally, these transactions and relationships have been seen as a necessary evil to obtain what an organization needs. The presumption has been that the world is composed

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of distinct businesses that thrive on autonomy and compete for supremacy. A company may be forced into interorganizational relationships depending on its needs and the instability and complexity of the environment.

A new view described by James Moore argues that organizations are now evolving into business ecosystems. An **organizational ecosystem** is a system formed by the interaction of a community of organizations and their environment. An ecosystem cuts across traditional industry lines.[5] For example, wireless service providers, handset manufacturers, makers of computer chips and other hardware, operating system and software providers, and applications developers are involved in an ecosystem for smartphones.[6] A similar concept is the *megacommunity approach*, in which businesses, governments, and nonprofit organizations join together across sectors and industries to tackle huge, compelling problems of mutual interest, such as energy development, world hunger, or cybercrime.[7]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Look for and develop relationships with other organizations. Don't limit your thinking to a single industry or business type. Build an ecosystem of which your organization is a part.

5.1a Is Competition Dead?

No company can go it alone under a constant onslaught of international competitors, changing technology, and new regulations. Organizations around the world are embedded in complex networks of confusing relationships—collaborating in some markets, competing fiercely in others. The U.S. retailer Walmart and Japan's large e-commerce business Rakuten formed a strategic alliance to help both companies better compete against Amazon. In the auto industry, Ford and Volkswagen have joined together in the production of pickup trucks and delivery vans that the two companies will sell under their own names in South America, Africa, and Europe, and they are discussing ways to share innovations in the development of electric and self-driving cars.[8]

Traditional competition, which assumes a distinct company competing for survival and supremacy with other stand-alone businesses, no longer exists because each organization both supports and depends on the others for success, and perhaps for survival. However, most managers recognize that the competitive stakes are higher than ever in a world where market share can crumble overnight, and no industry is immune from almost instant obsolescence.[9] In today's world, a new form of competition is in fact intensifying.[10]

For one thing, companies now need to co-evolve with others in the ecosystem so that everyone gets stronger. Consider the wolf and the caribou. Wolves cull weaker caribou, which strengthens the herd. A strong herd means that wolves must become stronger themselves. With co-evolution, the whole system becomes stronger. In the same way, companies co-evolve through discussion with each other, shared visions, alliances, and managing complex relationships.

Exhibit 5.1 illustrates the complexity of an ecosystem by showing the myriad overlapping relationships among companies involved in the development of self-driving and autonomous vehicles. Since the time this partnership map was created, some of the connections have changed. Ecosystems constantly change and evolve, with some relationships growing stronger while others weaken or are terminated. The changing pattern of relationships and interactions in an ecosystem contributes to the health and vitality of the system as an integrated whole.[11]

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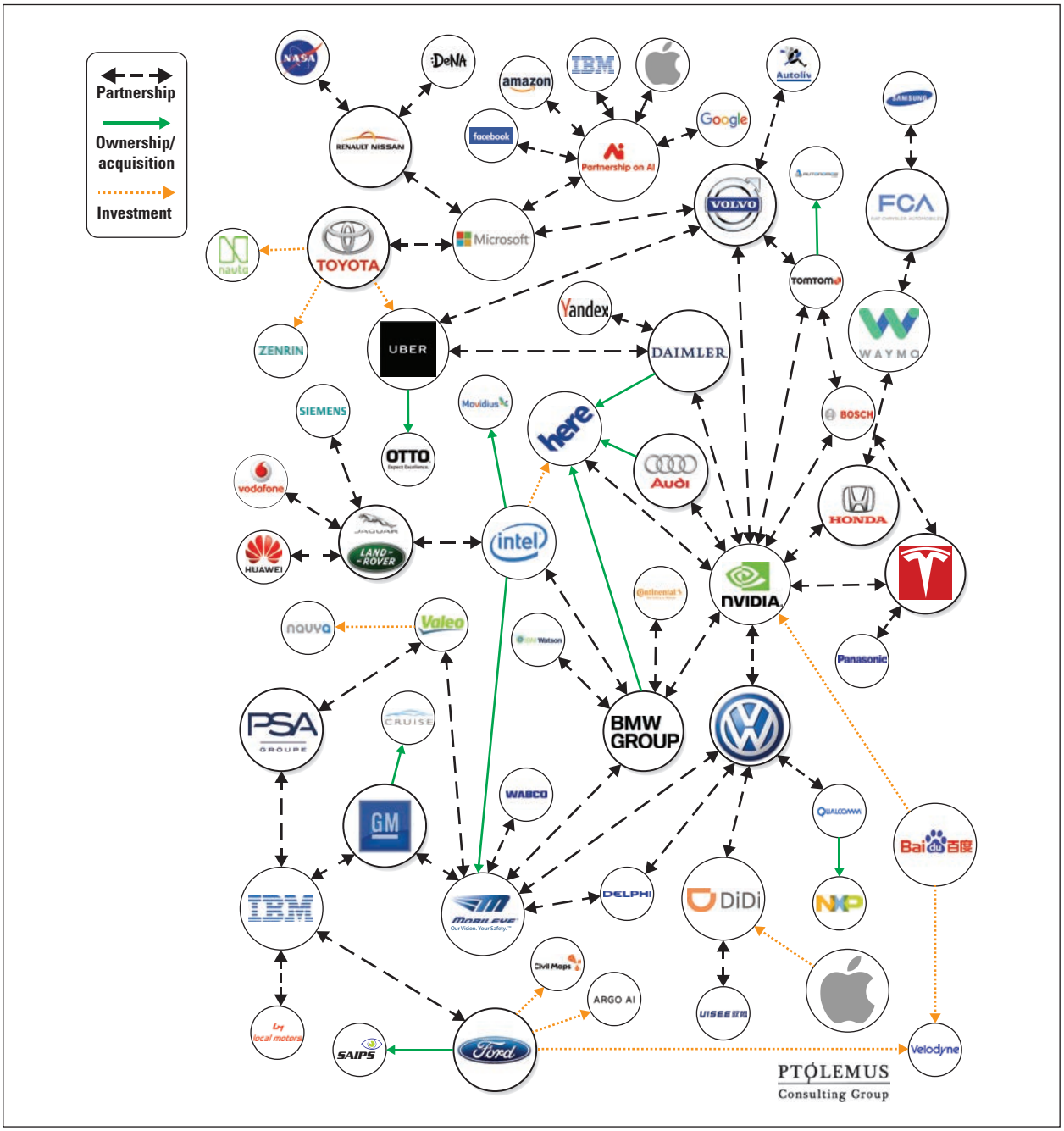
EXHIBIT 5.1
An Organizational Ecosystem



Source: Autonomous Vehicle Partnership Map, Autonomous Vehicle Global Study 2017, Ptølemus Consulting Group, https://www.ptolemus.com/autonomous-vehicle-global-study-2017/autonomous-vehicle-partnership-map/

In an organizational ecosystem, conflict and cooperation exist at the same time. For example, consider the case of Apple and Samsung.

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IN PRACTICE

Apple and Samsung

Samsung is Apple's most ferocious rival in the smartphone wars. The companies spent the better part of seven years suing and countersuing over the look, feel, and features of their phones before reaching an undisclosed settlement in mid-2018. Yet Samsung is also the biggest supplier of many key parts used in Apple's iPhones and iPads, including OLED displays and DRAM chips. One report indicates that Samsung earns around $110 from each iPhoneX sold by Apple.

When Apple first began collaborating with Samsung, the two companies didn't really compete, but that changed when Samsung got into producing smartphones that today eclipse the iPhone in terms of units shipped. Apple managers have tried to find alternate suppliers for some of the parts it uses from Samsung, but it isn't easy. The two firms have worked together for a decade to build custom chips, and Samsung is the only company producing the chips and OLED displays at the volume Apple needs. Apple executives realized Samsung had ambitions to compete with their company, but they needed the technology that only Samsung could deliver in large quantities. Samsung, meanwhile, needed the sales to Apple. Apple remains Samsung's biggest customer.

In early 2019, Apple and Samsung announced a partnership offering iTunes movies, TV shows, and other content on rival Samsung's television sets, tying the two companies even closer. "These are two of the largest companies on the planet deeply tied at the hip and directly competitive," said David Yoffie, a professor at Harvard Business School. "That makes this stand out compared with almost any relationship you can think of."[12]

Some companies believe cooperation is essential to success. Google, for example, has a whole team dedicated to giving away technology to the competition. Other companies, such as Apple, are less willing to cooperate, although they do so when it clearly benefits them.[13] In general, cooperation has become the rule in many industries and especially in high-tech firms. The business press is full of articles that talk about *frenemies* and *coopetition*, reflecting the trend toward companies being both friends and enemies, co-operators and competitors. Many companies that long prided themselves on independence have shifted to an ecosystem approach. Mutual dependencies and partnerships have become a fact of life. Is competition dead? Companies today may use their strength to achieve victory over competitors, but ultimately cooperation carries the day.

5.1b The Changing Role of Management

Within business ecosystems managers learn to move beyond traditional responsibilities of corporate strategy and designing hierarchical structures and control systems. Managers have to look beyond the boundaries of their own company and build relationships with a network of partners. For example, Tesla Motors owes much of its success to its managers' ability to establish successful partnerships. When Tesla began selling its first all-electric Roadster in 2008, the company had to build a market and a reputation from scratch. Tesla's production was also plagued by technical problems and a shortage of cash. Managers overcame these problems by turning rivals into partners. Tesla managers worked out an alliance with Daimler (the maker of Mercedes) in 2009 that gave the new organization access to first-class engineering, along with an infusion of cash that helped save the start-up from bankruptcy. An alliance with Toyota the following year enabled Tesla to buy the only remaining large-scale auto manufacturing plant in California, as well as gave it the chance to learn large-scale auto manufacturing from one of the best. More recently, Tesla has joined with Panasonic Corporation to jointly invest in a $5 billion lithium-ion battery plant.[14]

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If a top manager looks down to enforce order and uniformity, the company is missing opportunities for new and evolving external relationships.[15] In this new world, managers think about horizontal processes rather than vertical structures. Important initiatives are not just top down; they cut across the boundaries separating organizational units. Moreover, horizontal relationships now include linkages with suppliers and customers, who become part of the team. Business leaders can learn to lead economic co-evolution. Managers learn to see and appreciate the rich environment of opportunities that grow from cooperative relationships with other contributors to the ecosystem. Rather than trying to force suppliers into low prices or customers into high prices, managers strive to strengthen the larger system evolving around them, finding ways to understand this big picture and how to contribute.

This is a broader leadership role than ever before. Managers in charge of coordinating with other companies must learn new executive skills. For example, investigations found that the inability of managers to collaborate and communicate effectively across organizational boundaries played a significant role in the 2010 BP-Transocean Deepwater Horizon oil spill. One question raised by investigators concerned an argument between a BP manager and a Transocean manager that occurred on the rig the day of the explosion. BP and Federal agency managers also had trouble collaborating effectively in clean-up efforts.[16]

A study of executive roles by the Hay Group distinguished between *operations roles* and *collaborative roles*. Most traditional managers are skilled in handling operations roles, which have traditional vertical authority and are accountable for business results primarily through direct control over people and resources. Collaborative roles, on the other hand, don't have direct authority over horizontal colleagues or partners, but are nonetheless accountable for specific business results. Managers in collaborative roles must be highly flexible and proactive. They achieve results through personal communication and assertively seeking out needed information and resources.[17]

The old way of managing relied almost exclusively on operations roles, defending the organization's boundaries and maintaining direct control over resources. Today, though, collaborative roles are becoming more important for success. When partnerships fail, it is usually because of an inability of the partners to develop trusting, collaborative relationships rather than due to the lack of a solid business plan or strategy. In successful alliances, people work together almost as if they were members of the same organization.[18] Consider the U.S. war against terrorism. To fight terrorism, the U.S. government not only collaborates with governments of other countries but also with numerous private security companies. At the Pentagon's National Military Command Center, employees of private contracting firms work side-by-side with military personnel monitoring potential crises worldwide and providing information to top leaders. "We could not perform our mission without them," said Ronald Sanders, former chief of human capital at the Office of the Director of National Intelligence. "They serve as our reserves, providing flexibility and expertise we can't acquire. Once they are on board, we treat them as if they're part of the total force."[19]

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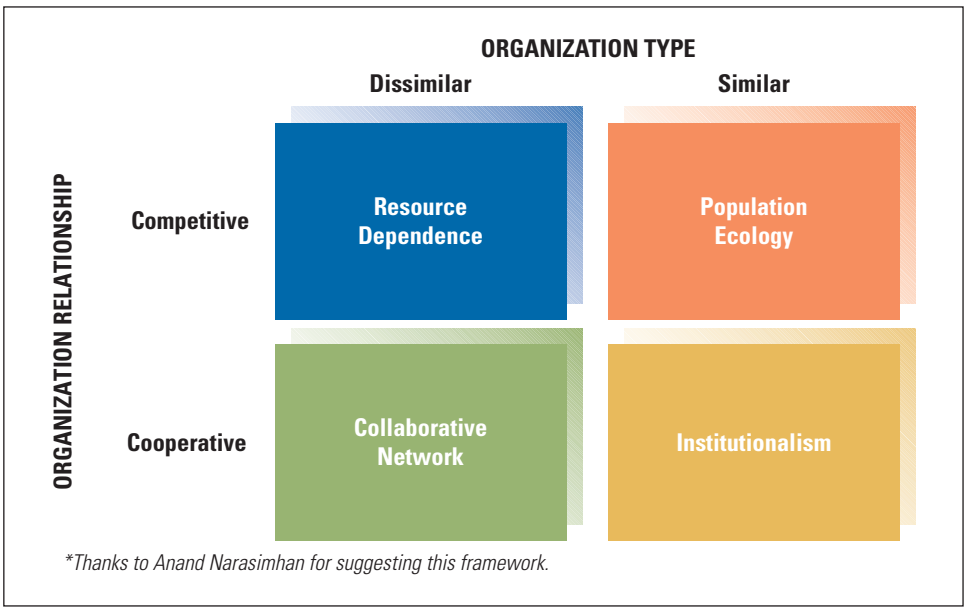
5.1c Interorganizational Framework

Appreciating the larger organizational ecosystem is one of the most exciting areas of organization theory. The models and perspectives for understanding interorganizational relationships ultimately help managers change their role from top-down management to horizontal coordination across organizations. Exhibit 5.2 shows a framework for analyzing the different views of interorganizational relationships. Relationships among organizations can be characterized by whether the organizations are dissimilar or similar and whether relationships are competitive or cooperative. By understanding these perspectives, managers can assess their environment and adopt strategies to suit their needs. The first perspective is called resource-dependence theory, which was described briefly in Chapter 4. It describes rational ways organizations deal with each other to reduce their dependence on the environment. The second perspective is about collaborative networks, wherein organizations allow themselves to become dependent on other organizations to increase value and productivity for all. The third perspective is population ecology, which examines how new organizations fill niches left open by established organizations and how a rich variety of new organizational forms benefits society. The final approach is called institutionalism, which explains why and how organizations legitimatize themselves in the larger environment and design structures by borrowing ideas from each other. These four approaches to the study of interorganizational relationships are described in the remainder of this chapter.



*Thanks to Anand Narasimhan for suggesting this framework.

EXHIBIT 5.2
A Framework of Interorganizational Relationships*

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REMEMBER THIS

- At one time organizations considered themselves autonomous and separate, trying to outdo other companies. Today more organizations see themselves as part of an ecosystem.
- In an ecosystem, the organization may span several industries and will be anchored in a dense web of relationships with other companies. Organizations may compete and collaborate at the same time, depending on the location and issue.
- In business ecosystems, the role of management is changing to include the development of horizontal relationships with other organizations. Collaboration skills with other organizations are becoming more important.
- Relationships among organizations can be organized into a framework by whether the organizations are dissimilar or similar and whether relationships are competitive or cooperative.
- Four perspectives that explain relationships among organizations are resource dependence theory, collaborative networks, population ecology, and institutionalism.

5.2 Resource Dependence

Resource dependence represents the traditional view of relationships among organizations. As described in Chapter 4, **resource-dependence theory** argues that organizations try to minimize their dependence on other organizations for the supply of important resources and try to influence the environment to make resources available.[20] Organizations succeed by striving for independence and autonomy. When threatened by greater dependence, organizations will assert control over external resources to minimize that dependence.

When organizations feel resource or supply constraints, the resource-dependence perspective says they maneuver to maintain their autonomy through a variety of strategies, several of which were described in Chapter 4. One strategy is to adapt to or alter the interdependent relationships. This could mean purchasing ownership in suppliers, developing long-term contracts or joint ventures to lock in necessary resources, or building relationships in other ways.

5.2a Types of Resource-Dependence Relationships

Organizations operating under the resource-dependence philosophy will do whatever is needed to avoid excessive dependence on other organizations and maintain control of resources and outcomes, thereby reducing their uncertainty. Exhibit 5.3 shows a hierarchy of resource-dependence relationships. The strategies at the top of the hierarchy offer managers more direct control over joint outcomes so that the organization can maintain its autonomy, whereas those at the bottom offer less direct control.

Acquisition/Merger. This type of relationship offers the greatest amount of control over joint outcomes because the acquiring firm absorbs all of the resources, assets, and liabilities of the target organization. For example, both Uber and its ride-hailing rival Lyft have bought bike-rental companies to offer customers cheaper and faster means of travel in dense cities where bike rentals and electric scooter rental firms

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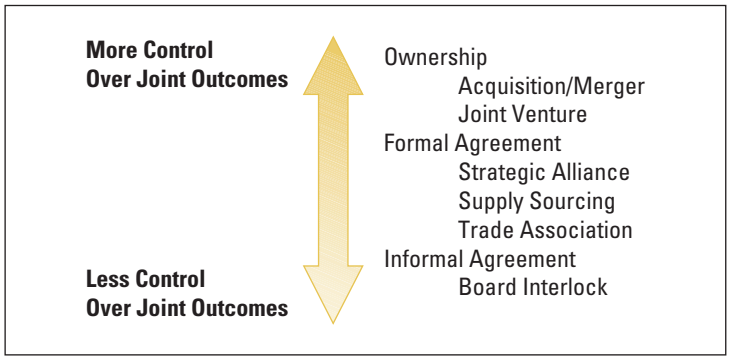
EXHIBIT 5.3
Types of Resource-Dependence Relationships



such as Bird Rides have become popular. Mattel acquired Canada's Mega Brands Inc. to expand its line of toys and compete with LEGO in the market for plastic construction blocks. With the acquisitions, Uber, Lyft, and Mattel will own the acquired company and control what happens with it.[21]

Joint Venture. A joint venture offers less control than full ownership. As Peter Drucker once said, "Businesses once grew by one of two ways: grass roots up, or by acquisition. . . . Today they grow through alliances—all kinds of dangerous alliances. Joint ventures and partnering which, by the way, very few people understand."[22] A **joint venture** is a new and distinct organizational entity set up by two or more organizations to jointly develop an innovative product or shared technology. Haven, the healthcare firm described at the beginning of this chapter, was set up as a joint venture by Amazon, Berkshire Hathaway, and JPMorgan Chase. Whirlpool has a joint venture with Hisense-Kelon Holdings Co. to make refrigerators and washers in China.[23] The successful video streaming site Hulu is a joint venture that was set up by News Corporation (later 21st Century Fox), Disney, and Comcast. After Disney bought 21st Century Fox in 2019, Hulu LLC is owned by Disney and Comcast. Although the companies compete with one another on the television airwaves, they knew they could be more competitive together than separately with video streaming.[24]

Strategic Alliance. A **strategic alliance** is less formal and binding than a joint venture. It is a collaborative agreement between two or more organizations that contribute resources to a common endeavor while maintaining their individuality. Numerous companies are involved in strategic alliances for technology related to self-driving vehicles, as illustrated previously in Exhibit 5.1. In late 2018, at least 46 different corporations were participating in various and sometimes overlapping alliances, joint ventures, and partnerships related to autonomous vehicle research and development.[25] Ford has partnered with or acquired a number of small firms working in artificial intelligence, mapping, and other technologies, and the company recently formed a partnership with Domino's to develop a fleet of self-driving pizza delivery vehicles. German luxury car rivals BMW and Daimler, the maker of Mercedes Benz, entered into a partnership in early 2019 to collaborate on self-driving technology. BMW also has an alliance with suppliers Intel and Mobileye, and Mercedes has an alliance with Bosch for driver assist technologies. Moreover, BMW has worked with ride-hailing firm Lyft to test self-driving vehicles, while Daimler will be now be doing the same with Lyft's main competitor Uber.[26]

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Supply Chain. Many organizations establish contracts with key suppliers to acquire resources to supplement in-house resources and capabilities. Rather than going it alone, companies such as Apple, Walmart, Dell, and Tesco develop deep, mutually beneficial relationships to make sure they have the supplies and resources they need. As one example, SCA (Svenska Cellulosa Aktiebolaget) uses fiber from recycled paper to make napkins, toilet paper, and paper towels for restaurants, offices, schools, and other institutions. When the supply of recycled paper went down in recent years due to reduced paper waste along with competition for the fiber from Chinese paper companies, SCA developed partnerships with numerous recycling centers, providing them with financial backing to upgrade equipment in exchange for the centers selling recovered fiber exclusively to SCA.[27] Positive, equitable relationships with suppliers have been found to result in higher levels of customer service, lower costs, and increased trust for organizations.[28]At the same time, companies don't want to become too dependent on one supplier. As described in the previous In Practice, Apple has tried to broaden its supplier base to reduce dependence on Samsung. The company also strives to contract with different companies to assemble its iPhones and iPads. The goal is to reduce risk and overdependence on one company in the supply chain.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Reach out and influence external people and organizations that threaten needed resources. Adopt strategies to control resources, especially when your organization is dependent and has little power. Assert your company's influence when you have power and control over resources.

Trade Association. A **trade association** is a federation that allows organizations, often in the same industry, to meet, share information, and monitor one another's activities. A trade association can also use collective resources to lobby for government policies to protect the industry. In early 2019, the National Cannabis Industry Association, the nation's largest trade group for the legal cannabis industry, hired Andrew Kline, a former vice-presidential advisor and federal prosecutor, to fill the newly created position of director of public policy. Kline will lead a group trying to influence federal and state public policy to protect and expand the legal cannabis industry.[29]

Board Interlock. A board interlock occurs when a director serves on the boards of multiple companies, creating connections among the companies. The candy company Hershey, for example, has for decades had a board with at least a dozen interlocks with other companies at any one time.[30] This practice also occurs frequently in Silicon Valley, where venture capitalist Marc Andreessen is a director of several firms, including eBay, Hewlett-Packard, and Facebook.[31]

5.2b Power Implications

In resource-dependence relationships, large independent companies have power over smaller suppliers or partners. When a large company such as Walmart has power over small suppliers, for instance, it can ask the companies for shipping deals or lower prices and the companies have little choice but to go along. Walmart began imposing fines on suppliers that fail to meet its tough standards for complete on-time deliveries. Disney illustrated its power by requiring movie theaters to show "Star Wars: The Last Jedi" in their largest auditorium for at least four weeks and to agree to other special requirements. Even though Disney was already getting 65 percent of revenue from U.S. ticket sales, theaters that violated any part of the agreement would have to hand over an additional five percent.[32]

Resource dependence can work in the opposite direction too. Auto companies such as Toyota and General Motors are working to develop a new type of lightweight electric motor that doesn't require the use of neodymium, a rare earth mineral that is almost entirely mined and refined in China. Chinese suppliers have power over the auto companies as they strive to create more hybrid and electric

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vehicles, and the price of the mineral has soared.[33] Power relationships in various industries are always shifting. Managers in industries ranging from pharmaceuticals to banking are wrestling with the growing power of Amazon. Consider the relationship between JPMorgan Chase and the giant of e-commerce.

IN PRACTICE
JPMorgan Chase and Amazon

Twenty years ago, JPMorgan Chase's revenue dwarfed that of Amazon. Today, things have shifted in the other direction. Amazon had its first $200 billion sales year in 2018, while revenue at JPMorgan Chase for 2018 was around $131 billion. The retailer's market value is more than twice that of the banking firm.

Amazon and JPMorgan Chase have long had a close relationship. Amazon struck a credit card deal with JPMorgan Chase in 2002, when Amazon's business consisted mostly of selling books and CDs online. A few years before that, Amazon founder and CEO Jeff Bezos had tried to hire Jamie Dimon to be Amazon's president. Dimon turned down the offer, saying it wasn't the right time to make such a dramatic change. "I had this vision I'd never wear a suit again. I'd live in a houseboat," Dimon told a CNBC reporter about considering the decision. Dimon joined JPMorgan Chase in 2004, becoming its CEO the following year. Over the next couple of decades, Amazon's sales—and its power—soared. When time came to renegotiate the credit card agreement, Amazon asked for a far higher percentage of card revenue and other concessions. Dimon might not have been happy, but he eventually signed off on the deal because Amazon was too big and powerful to put the relationship at risk.

Since then, the fortunes of the two companies have become increasingly intertwined. As described at the beginning of this chapter, the two have joined with Berkshire Hathaway in a healthcare venture, and they also partner in other ways. A key consideration of the shifting power dynamics for Dimon and JPMorgan is the question of Amazon potentially making a move into providing its own financial services. Dimon began thinking about the issue a few years ago and put together a team to consider various ways Amazon might get into financial services and how JPMorgan could fit in. As Amazon continues to grow larger and more powerful, Dimon and other executives at JPMorgan Chase want to find ways to be a partner rather than a casualty.[34]

REMEMBER THIS

- The resource-dependence perspective is the traditional view of interorganizational relationships, arguing that organizations try to avoid excessive dependence on other organizations. In this view, organizations devote considerable effort to controlling the environment to ensure ample resources while maintaining independence.
- Types of resource-dependence relationships include acquisitions or mergers, joint ventures, strategic alliances, supply sourcing, trade associations, and board interlocks.
- Power affects an organization's influence in a partnership. Power relationships among organizations are always changing, with some organizations increasing their power and others becoming less influential.

5.3 Collaborative Networks

The **collaborative-network perspective** is an emerging alternative to resource-dependence theory. Companies join together to become more competitive and to share scarce resources. Large aerospace firms partner with one another and with smaller companies and suppliers to design next-generation jets. Large

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pharmaceutical companies join with small biotechnology firms to share resources and knowledge and spur innovation. Consulting firms, investment companies, and accounting firms may join in an alliance to meet customer demands for expanded services.[35] Five leading medical groups spanning several states and millions of patients joined in a consortium to share electronic data, including patient health records. Geisinger Health System, Kaiser Permanente, Mayo Clinic, Intermountain Healthcare, and Group Health Cooperative believe using and sharing digitized patient records can help healthcare providers make smarter decisions and provide better care, such as referring a patient to a specialist in another system.[36] Corporate alliances require managers who are good at building personal networks across boundaries. How effective are you at networking? Complete the questionnaire in the "How Do You Fit the Design?" box to find out.

HOW DO YOU FIT THE DESIGN?

PERSONAL NETWORKING

Are you a natural at reaching out to others for personal networking? Having multiple sources of information is a building block for partnering with people in other organizations. To learn something about your networking, answer the following questions. Please answer whether each item is Mostly True or Mostly False for you in school or at work.

		Mostly True	Mostly False
1.	I learn early on about changes going on in the organization and how they might affect me or my job.	_____	_____
2.	I network as much to help other people solve problems as to help myself.	_____	_____
3.	I join professional groups and associations to expand my contacts and knowledge.	_____	_____
4.	I know and talk with peers in other organizations.	_____	_____
5.	I act as a bridge from my work group to other work groups.	_____	_____
6.	I frequently use lunches to meet and network with new people.	_____	_____
7.	I regularly participate in charitable causes.	_____	_____
8.	I maintain a list of friends and colleagues to whom I send holiday cards.	_____	_____
9.	I maintain contact with people from previous organizations and school groups.	_____	_____
10.	I actively give information to subordinates, peers, and my boss.	_____	_____

Scoring: Give yourself one point for each item marked as Mostly True. A score of 7 or higher suggests very active networking. If you scored 3 or less, reaching out to others may not be natural for you and will require extra effort.

Interpretation: In a world of adversarial relationships between organizations, networking across organizational boundaries was not important. In a world of interorganizational partnerships, however, many good things flow from active networking, which will build a web of organizational relationships to get things done. If you are going to manage relationships with other organizations, networking is an essential part of your job. Networking builds social, work, and career relationships that facilitate mutual benefit. People with large, active networks tend to enjoy and contribute to partnerships and have broader impact on interorganizational relationships.

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5.3a Why Collaboration?

Why all this interest in interorganizational collaboration? Some companies have moved away from the idea of remaining independent to allow themselves to develop mutually dependent relationships with other organizations and accomplish things none of the organizations could do alone. There has been a tremendous surge in the formation of strategic alliances, for example, over the past three decades, with both large established firms and small entrepreneurial firms taking advantage of the benefits of collaboration.[37] Some key reasons for collaboration include sharing risks when entering new markets, mounting expensive new programs and reducing costs, and enhancing the organization's profile in selected industries or technologies. Cooperation and collaboration are prerequisites for greater innovation, adaptation, problem solving, and performance.[38] Partnerships are also a major avenue for entering global markets, with both large and small firms developing partnerships overseas and in North America. Joint ventures with organizations in other countries, for example, make up a substantial portion of U.S. firms' foreign investment and entry strategies.[39]

North American companies traditionally have worked alone, competing with each other and believing in the tradition of individualism and self-reliance, but they have learned from their international experience just how effective interorganizational relationships can be. Both Japan and Korea have long traditions of corporate clans or industrial groups that collaborate and assist each other. North Americans typically have considered interdependence a bad thing, believing it would reduce competition. However, the experience of collaboration in other countries has shown that competition among companies can be fierce in some areas even as they collaborate in others. It is as if the brothers and sisters of a single family went into separate businesses and want to outdo one another, but they will help each other out when push comes to shove.

1 Organizations should strive to be as independent and self-sufficient as possible so that their managers aren't put in the position of "dancing to someone else's tune."

ASSESS YOUR ANSWER

ANSWER: *Disagree.* Trying to be separate and independent is the old way of thinking. This view says organizations should minimize their dependence on other firms so that they don't become vulnerable. Today, though, successful companies see collaboration as a better approach to maintaining a balance of power and getting things done.

Interorganizational linkages provide a kind of safety net that encourages long-term investment, information sharing, and risk taking. Organizations can achieve higher levels of innovation and performance as they learn to shift from an adversarial to a partnership mindset.[40] Consider the following examples:

- To make "The Lego Movie," Denmark-based Lego A/S negotiated partnerships with several companies, such as digital studio Animal Logic, which developed the animation and visual effects, and Warner Brothers Pictures, which provided financing and distribution. Thanks to partnerships, "The Lego Movie" was made on a $60 million budget and it grossed more than $450 million in the year following its release.[41]

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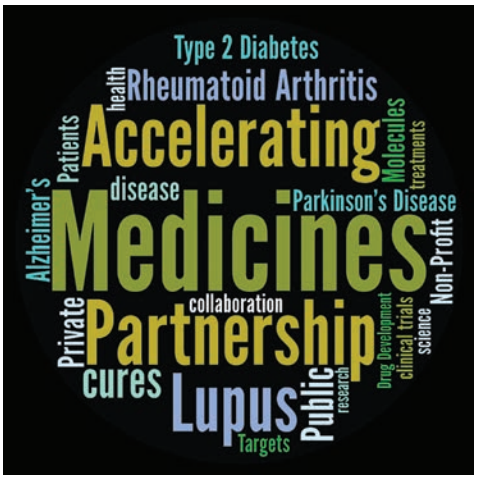
- Ford Motor Company and Toyota compete fiercely to sell cars and trucks, but to fend off new rivals such as Alphabet getting into the auto business, Toyota teamed with Ford to integrate Ford's apps platform into Toyota vehicles. [42]
- A study by PwC (PricewaterhouseCoopers) found that 27 percent of responding CEOs said they were considering or were already working with a competitor in some type of partnership.[43]
- Roche Holding AG and AstraZeneca PLC developed a partnership to share data on early-stage drug design to increase the odds of developing safe and effective drugs. The data will also be shared with a third company, MedChemica Ltd., which specializes in scrutinizing chemical compounds to pinpoint chemical structures that might create safety problems. The companies say they hope other pharmaceutical companies will join the data-sharing partnership, leading to the creation of safer, more effective drugs.[44] Pharmaceutical companies have until recently been protective of their research data, but there is a noted trend toward collaboration, such as the Accelerating Medicines Partnership.

IN PRACTICE

Accelerating Medicines Partnership

Companies have spent billions of dollars racing to beat one another to find breakthrough drugs for diseases like Alzheimer's. Now, 12 biopharmaceutical and life sciences companies have joined with the National Institutes of Health (NIH), the Food and Drug Administration (FDA), and numerous non-profit agencies in a collaborative agreement to find new cures and reduce the time and cost of finding them. The companies will share scientists, tissue and blood samples, and research data. By collaborating, the scientists hope to interpret Alzheimer's, Type 2 diabetes, autoimmune disorders such as lupus and rheumatoid arthritis, and Parkinson's disease in a way none of the companies have been able to do on their own and identify targets for new drugs.



National Institutes of Health (NIH)

Called the Accelerating Medicines Partnership, the group includes companies that compete vigorously, such as Bristol-Myers Squibb, Pfizer, GlaxoSmithKline, Eli Lilly, Sanofi, and Merck. The pact prevents any company from using a discovery until the project makes data on the discovery public. "The moment the project results are out," said David Wholley of the NIH, "all-out competition resumes to develop the winning drug."

Getting the pact pulled together wasn't easy. At times, some of the participants "weren't even talking with one another." Jan Lundbert, who leads Eli Lilly & Company's research laboratories, said figuring out how to collaborate despite being rivals had a "bonding role: Do we respect each other as scientists and as human beings?"[45]

5.3b From Adversaries to Partners

Fresh flowers are blooming on the battle-scarred landscape where once-bitter rivalries once took place. In North America, collaboration among organizations initially

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occurred in nonprofit social service and mental health organizations, where public interest was involved. Community organizations collaborated to achieve greater effectiveness and better use of scarce resources.[46] With the push from international competitors and international examples, hard-nosed American business managers soon began shifting to a new partnership paradigm on which to base their relationships.

Exhibit 5.4 provides a summary of this change in mindset.[47] Rather than organizations maintaining independence, the new model is based on interdependence and trust. Performance measures for the partnership are loosely defined, and problems are resolved through discussion and dialogue. Managing strategic relationships with other firms has become a critical management skill, as discussed in this chapter's BookMark. In the new orientation, people try to add value to both sides and believe in high commitment rather than suspicion and competition. Companies work toward equitable profits for both sides rather than just for their own benefit. The new model is characterized by lots of shared information, including electronic linkages and face-to-face discussions to provide feedback and solve problems. Sometimes people from other companies are on site to enable very close coordination. Partners develop equitable solutions to conflicts rather than relying on legal contracts and lawsuits. Contracts may be loosely specified, and it is not unusual for business partners to help each other outside whatever is specified in the contract.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Seek collaborative partnerships that enable mutual dependence and enhance value and gain for both sides. Get deeply involved in your partner's business, and vice versa, to benefit both.

EXHIBIT 5.4
Changing Characteristics of Interorganizational Relationships

Traditional Orientation: Adversarial	New Orientation: Partnership
Low dependence	**High dependence**
Suspicion, competition, arm's length	Trust, addition of value to both sides, high commitment
Detailed performance measures, closely monitored	Loose performance measures; problems discussed
Price, efficacy, own profits	Equity, fair dealing, both profit
Limited information and feedback	Electronic linkages to share key information, problem feedback, and discussion
Legal resolution of conflict	Mechanisms for close coordination; people on site
Minimal involvement and up-front investment, separate resources	Involvement in partner's product design and production, shared resources
Short-term contracts	Long-term contracts
Contract limiting the relationship	Business assistance beyond the contract

Sources: Based on Mick Marchington and Steven Vincent, "Analysing the Influence of Institutional, Organizational, and Interpersonal Forces in Shaping Inter-Organizational Relations," *Journal of Management Studies* 41, no. 6 (September 2004), 1029–1056; Jeffrey H. Dyer, "How Chrysler Created an American Keiretsu," *Harvard Business Review*, July–August 1996, 42–56; Myron Magnet, "The New Golden Rule of Business," *Fortune*, February 21, 1994, 60–64; and Peter Grittner, "Four Elements of Successful Sourcing Strategies," *Management Review*, October 1995, 41–45.

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BOOKMARK 5.0 HAVE YOU READ THIS BOOK?

Managing Strategic Relationships: The Key to Business Success

By Leonard Greenhalgh

What determines organizational success in the twenty-first century? According to Leonard Greenhalgh, author of *Managing Strategic Relationships: The Key to Business Success*, it's how successfully managers support, foster, and protect collaborative relationships both inside and outside the firm. In separate chapters, the book offers strategies for managing relationships between people and groups within the company and with other organizations. Effectively managing relationships generates a sense of commonwealth and consensus, which ultimately results in competitive advantage.

MANAGING RELATIONSHIPS IN A NEW ERA

Greenhalgh says managers need a new way of thinking to fit the realities of the new era. He offers the following guidelines:

- *Recognize that detailed legal contracts can undermine trust and goodwill.* Greenhalgh stresses the need to build relationships that are based on honesty, trust, understanding, and common goals instead of on narrowly defined legal contracts that concentrate on what one business can give to the other.
- *Treat partners like members of your own organization.* Members of partner organizations need to be active participants in the learning experience by becoming involved in training, team meetings, and other activities. Giving a partner organization's employees a chance to make genuine contributions promotes deeper bonds and a sense of unity.
- *Top managers must be champions for the alliance.* Managers from both organizations have to act in ways that signal to everyone inside and outside the organization a new emphasis on partnership and collaboration. Using ceremony and symbols can help instill a commitment to partnership in the company culture.

A PARTNERSHIP PARADIGM

To succeed in today's environment, old-paradigm management practices based on power, hierarchy, and adversarial relationships must be traded for new-era commonwealth practices that emphasize collaboration and communal forms of organization. The companies that will thrive, Greenhalgh believes, "are those that really have their act together—those that can successfully integrate strategy, processes, business arrangements, resources, systems, and empowered workforces." That can be accomplished, he argues, only by effectively creating, shaping, and sustaining strategic collaborative relationships.

Managing Strategic Relationships: The Key to Business Success, by Leonard Greenhalgh, is published by The Free Press.

In this new view of partnerships, dependence on another company is seen to reduce rather than increase risks. Greater value can be achieved by both parties. By being entwined in a system of interorganizational relationships, everyone does better because they help one another. This is a far cry from the belief that organizations do best by being autonomous. The partnership mindset can be seen in a number of industries. For example, aircraft manufacturers EADS, Embraer, and Boeing have teamed up to develop aviation biofuel.[48] Top medical centers, such as the Mayo Clinic, the MD Anderson Cancer Center, and Community Health Systems, have formed partnerships with networks of clinics or smaller nonprofit hospitals to expand their services and leverage their brands.[49] Auto companies have formed numerous partnerships to share development costs for self-driving vehicles.

By breaking down boundaries and becoming involved in partnerships with an attitude of fair dealing and adding value to both sides, today's companies are changing the concept of what makes an organization.

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REMEMBER THIS

- The collaborative-network perspective is an emerging alternative to resource dependence. Organizations welcome collaboration and interdependence with other organizations to enhance value for all.
- Many executives are changing mindsets away from organizational autonomy toward collaboration, often with former corporate enemies.
- The new partnership mindset emphasizes trust, fair dealing, and achieving profits for all parties in a relationship.

5.4 Population Ecology

This section introduces a different perspective on relationships among organizations. The **population-ecology perspective** differs from the other perspectives because it focuses on organizational diversity and adaptation within a population of organizations.[50] A **population** is a set of organizations engaged in similar activities with similar patterns of resource utilization and outcomes. Organizations within a population compete for similar resources or similar customers, such as financial institutions in the Seattle area or car dealerships in Houston, Texas.

Within a population, the question asked by ecology researchers is about the large number and variation of organizations in society. Why are new organizational forms that create such diversity constantly appearing? The answer is that individual organizational adaptation is severely limited compared to the changes demanded by the environment. Innovation and change in a population of organizations take place through the birth of new types of organizations more so than by the reform and change of existing organizations. Indeed, organizational forms are considered relatively stable, and the good of a whole society is served by the development of new forms of organization through entrepreneurial initiatives. New organizational form meets the new needs of society more than established organizations that are slow to change.[51]

What does this theory mean in practical terms? It means that large, established organizations often become dinosaurs and perish. Consider that among the companies that appeared on the first *Fortune 500* list in 1955, only 71 stayed on the list for 50 years. Some were bought out or merged with other companies. Others simply declined and disappeared. Large, established firms often have tremendous difficulty adapting to a rapidly changing environment. Hence, new organizational forms that fit the current environment emerge, fill a new niche, and over time take away business from established companies.[52] According to the population-ecology view, when looking at an organizational population as a whole, the changing environment determines which organizations survive or fail. The assumption is that individual organizations suffer from structural inertia and find it difficult to adapt to environmental changes. Thus, when rapid change occurs, old organizations are likely to decline or fail, and new organizations emerge that are better suited to the needs of the environment. For example, when Blockbuster couldn't adapt to Netflix's impact on how people watch movies at home, the company's 9,000 video rental stores declined by March 2019 to a single store in Bend, Oregon, where managers say they have no intention of closing.

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IN PRACTICE
Blockbuster

Alexander Oganezov/Shutterstock.com

Unless you live near Bend, Oregon, you probably don't remember Blockbuster. When Netflix first came along, Blockbuster had around 9,000 stores and 60,000 employees. Customers walked in, browsed through hundreds or thousands of movie titles to pick one or a few to rent for the weekend, maybe added some popcorn and candy at the cash register, then took the videos home to watch. Those days are long gone. Blockbuster filed for bankruptcy in 2010, and the number of stores quickly shrivelled to a few holdouts. Now, the outlet in Bend, Oregon is the sole survivor.

When general manager Sandi Harding heard that her store would be the last Blockbuster on the planet, she posted a message on Facebook saying, "Holy Cow it's exciting!" The store held a party, serving a special beer called the Last Blockbuster crafted by a local brewery. In addition to videos for rent, the store sells Blockbuster-branded merchandise such as trucker hats, coffee cups, and magnets that are made by a local teacher. The Bend store became a Blockbuster franchise in 2000. It has several years left on its lease and a license agreement the owners sign annually with Dish Network, which bought Blockbuster in 2011.

The store has survived partly because Bend is in a region where many small communities don't yet have access to the high-speed Internet needed for content streaming. How long it can survive when that changes remains to be seen. For now, the store has around 4,000 active video rental accounts, and tourists sometimes travel hours out of their way to stop in the last Blockbuster. "It's almost reenergized us, that we're the last one," Harding says. "They treat us like celebrities."[53]

5.4a What Hinders Adaptation?

Why do established organizations have such a hard time adapting? Michael Hannan and John Freeman, originators of the population-ecology model of organization, argue that there are many limitations on the ability of organizations to change. The limitations come from heavy investment in plants, equipment, and specialized personnel; limited information; the established viewpoints of decision makers; the organization's own successful history that justifies current procedures; and the difficulty of changing corporate culture. True transformation is a rare and unlikely event in the face of all these barriers.[54] Consider how a Swiss watchmaker is trying to adapt in a changed world.

IN PRACTICE
LVMH Moët Hennessy Louis Vuitton

When someone asks *What time is it?* do you check your watch or your smartphone? If you're like many people today, you haven't worn a watch for years, if ever. Now, a 68-year-old Swiss watchmaking executive, Jean-Claude Biver, is doing everything he can to get younger generations interested in buying Swiss-made watches before the centuries-old industry dies out for good.

LVMH's least-expensive TAG Heuer model is $1,000, but many luxury Swiss watches cost more than a new car. In addition, new technology companies are offering wrist gadgets that track movements, display e-mails, and organize the wearer's social life. Biver was quick to recognize the threat of Apple's first $400 smartwatch, and he tried to turn it into an opportunity. Biver thought if TAG Heuer developed its own smartwatch, it could lure younger customers to the company's mechanical timepieces as well. He moved so quickly to develop the first TAG Heuer smartwatch that it was ready for market just a few months after Apple's smartwatch went on sale. Since 2015, TAG Heuer has made more than 100,000 sales of the $1,500 "connected watch," but it didn't meet one of Biver's primary goals—customers still weren't all that interested in the company's mechanical watches.

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Swiss watch manufacturers have rebranded themselves to survive before, but it remains to be seen if they can do it again. One 27-year-old said of wearing a watch, "It's a habit that I lost." Another said Swiss watches are just too expensive. "With that money, I could do so many other things, like go on a trip." Biver knows he's dealing with a new mindset in a new generation. "How can I understand the Millennials?" Biver says. "It's impossible. I'm 68. I cannot understand. But I can learn."[55]

Another industry that is struggling to adapt is the traditional bookstore. When Jeff Bezos gave a talk at the Harvard Business School in 1997, one student bluntly told him, "You seem like a really nice guy. . . but you really need to sell to Barnes & Noble and get out now." Today, Amazon is thriving and Barnes & Noble is struggling to survive. Jeff Bezos knew that it is extremely difficult for large established companies to shift to a new way of doing things. Another example comes from Kodak, which actually invented some of the earliest digital photographic technology but couldn't accept that customers would give up on the company's traditional film. Kodak had been successful for so long and was so large and entrenched in its way of doing business that it couldn't change substantively even when managers wanted to.[56]

The population-ecology model is developed from theories of natural selection in biology, and the terms *evolution* and *selection* are used to refer to the underlying behavioral processes. Theories of biological evolution try to explain why certain life forms appear and survive whereas others perish. Some theories suggest the forms that survive are typically best fitted to the immediate environment. The environment of the 1940s and 1950s was suitable to Woolworth, a variety retailer and one of the pioneers of the "five-and-dime store" business, but new organizational forms like Walmart and other superstores became dominant in the 1980s and early 1990s. Now, the environment is shifting again, indicating that the "big box" era may be coming to a close. With more people shopping online, smaller stores once again have an advantage in brick-and-mortar retail. Walmart has opened nearly 700 small-scale Walmart Neighborhood Markets. Target has also begun opening small-format stores in urban areas. No company is immune to the processes of social change. In recent years, technology has brought tremendous environmental change, leading to the decline of many outdated organizations and a proliferation of new companies such as Snapchat, Uber, Netflix, Facebook, Airbnb, and Twitter.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Adapt your organization to new variations being selected and retained in the external environment. If you are starting a new organization, find a niche that contains a strong environmental need for your product or service, and be prepared for a competitive struggle over scarce resources.

5.4b Organizational Form and Niche

The population-ecology model is concerned with organizational forms. **Organizational form** is an organization's specific technology, structure, products, goals, and personnel, which can be selected or rejected by the environment. Each new organization tries to find a **niche** (i.e., a domain of unique environmental resources and needs) sufficient to support it. Roth Martin and Steven Hawthornwaite, founders of Rothy's, identified a niche selling comfortable, fashionable, washable shoes made from post-consumer plastic water bottles, recycled foam, and other sustainable materials.[57] The niche is usually small in the early stages of an organization but may increase in size over time if the organization is successful. If the organization doesn't find an appropriate niche, it will decline and may perish.

From the viewpoint of a single firm, luck, chance, and randomness play important parts in survival. New products and ideas are continually being proposed by both entrepreneurs and large organizations. Whether these ideas and organizational

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forms survive or fail is often a matter of chance—whether external circumstances happen to support them. A woman starting a small electrical contracting business in a rapidly growing area such as McKinney, Texas, or Cary, North Carolina (two of the fastest growing cities in 2019), would have an excellent chance of success. If the same woman were to start the same business in a declining community elsewhere in the United States, her chance of success would be far less. Success or failure of a single firm thus is predicted by the characteristics of the environment as much as by the skills or strategies used by the organization's managers.

ASSESS YOUR ANSWER

2 The success or failure of a start-up is largely determined by the smarts and management ability of the entrepreneur.

ANSWER: *Disagree.* Luck is often as important as smarts because larger forces in the environment, typically unseen by managers, allow some firms to succeed and others to fail. If a startup happens to be in the right place at the right time, chances for success are much higher, regardless of management ability.

5.4c Process of Ecological Change

The population-ecology model assumes that new organizations are always appearing in the population. Thus, organizational populations are continually undergoing change. The process of change in the population occurs in three stages: variation, selection, and retention, as summarized in Exhibit 5.5.

- *Variation*. **Variation** means the appearance of new, diverse forms in a population of organizations. These new organizational forms are initiated by entrepreneurs, established with venture capital by large corporations, or set up by governments seeking to provide new services. Some forms may be conceived to cope with a perceived need in the external environment. Mert Iseri founded SwipeSense, a company whose first product was a digital hand-hygiene system, to prevent some of the estimated 100,000 deaths that occur each year in the United States from hospital-acquired infections.[58] In recent years, a large number of new firms have been initiated to develop applications for smartphones and social networking sites, to develop computer software, to provide consulting and other services to large corporations, and to develop products and technologies for Internet commerce. Other new organizations produce a traditional product or service, but do it using new technology, new business models, or new management techniques that make the new companies far more able to survive. For instance, people get the same type of benefit from Uber or Lyft that they could get from a traditional taxi company, but the business model and technology these new companies use is more efficient and less expensive than that of Checker Taxi or Yellow Cab. Organizational variations are analogous to mutations in biology, and they add to the scope and complexity of organizational forms in the environment.

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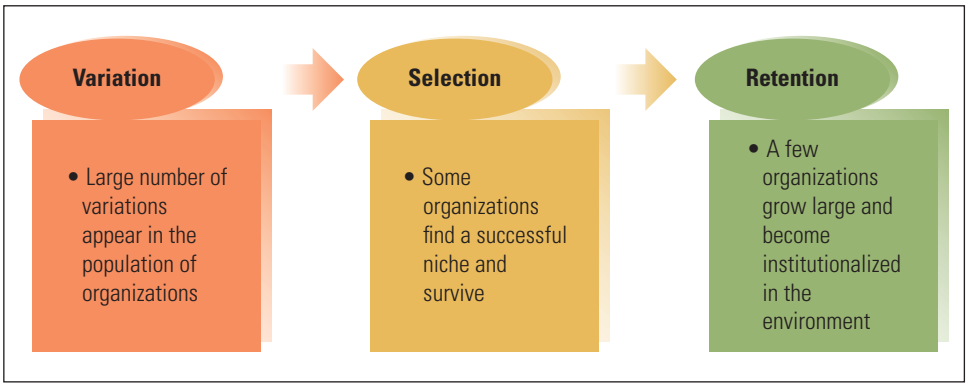
Variation
• Large number of variations appear in the population of organizations
Selection
• Some organizations find a successful niche and survive
Retention
• A few organizations grow large and become institutionalized in the environment

EXHIBIT 5.5
Elements in the Population Ecology Model of Organizations

- *Selection.* **Selection** refers to whether a new organizational form is suited to the environment and can survive. Only a few variations are "selected in" by the environment and survive over the long term. Some variations will suit the external environment better than others. Some prove beneficial and thus are able to find a niche and acquire the resources from the environment necessary to survive. Other variations fail to meet the needs of the environment and perish. When there is insufficient demand for a firm's product or service and when insufficient resources are available to the organization, that organization will be "selected out."
- *Retention.* **Retention** is the preservation and institutionalization of selected organizational forms. Certain technologies, products, and services are highly valued by the environment. The retained organizational form may become a dominant part of the environment. Many forms of organization have been institutionalized, such as government, schools, churches, and automobile manufacturers. McDonald's, which owns 45 percent of the U.S. fast-food market and provides the first job for many teenagers, has become institutionalized in American life.

Institutionalized organizations like McDonald's seem to be relatively permanent features in the population of organizations, but they are not permanent in the long run. The environment is always shifting, and if the dominant organizational forms don't adapt to external change, they will gradually diminish and be replaced by other organizations.

From the population-ecology perspective, the environment is the important determinant of organizational success or failure. The organization must meet an environmental need or else it will be selected out. The principles of variation, selection, and retention lead to the establishment of new organizational forms in a population of organizations.

5.4d Strategies for Survival

Another principle that underlies the population-ecology model is the **struggle for existence**, or competition. Organizations and populations of organizations are engaged in a competitive struggle over resources, and each organizational form

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is fighting to survive. The struggle is most intense among new organizations, and both the birth and survival frequencies of new organizations are related to factors in the larger environment. Historically, for example, factors such as size of urban area, percentage of immigrants, political turbulence, industry growth rate, and environmental variability have influenced the launching and survival of newspapers, telecommunication firms, railroads, government agencies, labor unions, and even voluntary organizations.[59]

In the population-ecology perspective, **generalist** and **specialist** strategies distinguish organizational forms in the struggle for survival. Organizations with a wide niche or domain—that is, those that offer a broad range of products or services or that serve a broad market—are generalists. Organizations that provide a narrower range of goods or services or that serve a narrower market are specialists.

In the natural environment, a specialist form of flora and fauna would evolve in protective isolation in a place like Hawaii, where the nearest body of land is 2,000 miles away. The flora and fauna are heavily protected. In contrast, a place like Costa Rica, which experienced wave after wave of external influences, developed a generalist set of flora and fauna that has better resilience and flexibility for adapting to a broad range of environments. In the business world, a company such as Yottoy (toy spelled backward and forward), which manufactures character-driven toys such as Madeline, Paddington Bear, Girl Scout Friendship Dolls, Mo Willems' Elephant and Piggie, and others, would be considered a specialist, whereas Mattel is a generalist, marketing a broad range of toys for boys and girls of all ages.[60]

Specialists are generally more competitive than generalists in the narrow area in which their domains overlap. However, the breadth of the generalist's domain serves to protect it somewhat from environmental changes. Though demand may decrease for some of the generalist's products or services, it usually increases for others at the same time. In addition, because of the diversity of products, services, and customers, generalists are able to reallocate resources internally to adapt to a changing environment, whereas specialists are not. However, because specialists are often smaller companies, they can sometimes move faster and be more flexible in adapting to changes.[61] Yottoy's founder and president Kate Karcher Clark, for example, says the company's success comes partly from its ability to respond quickly to market trends and other changes in the environment.[62] Managerial impact on company success often comes from selecting a strategy that steers a company into an open niche.

REMEMBER THIS

- The population-ecology perspective explains why organizational diversity continuously increases with the appearance of new organizations filling niches left open by established companies.
- This perspective asserts that large companies usually cannot adapt to meet a changing environment; hence, new companies emerge with the appropriate form and skills to serve new needs.
- Through the process of variation, selection, and retention, some organizations will survive and grow while others perish.
- Companies may adopt a generalist or specialist strategy to survive in the population of organizations.

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5.5 Institutionalism

The institutional perspective provides yet another view of interorganizational relationships.[63] The **institutional perspective** describes how organizations survive and succeed through congruence between an organization and the expectations from its environment. The **institutional environment** is composed of norms and values from stakeholders (e.g., customers, investors, associations, boards, other organizations, government, and the community). Thus, the institutional view believes that organizations adopt structures and processes to please outsiders, and these activities come to take on rule-like status in organizations. The institutional environment reflects what the greater society views as correct ways of organizing and behaving.[64]

Legitimacy is defined as the general perception that an organization's actions are desirable, proper, and appropriate within the environment's system of norms, values, and beliefs.[65] Institutional theory thus is concerned with the set of intangible norms and values that shape behavior, as opposed to the tangible elements of technology and structure. Organizations and industries must fit within the cognitive and emotional expectations of their audience. For example, people will not deposit money in a bank unless it sends signals of compliance with norms of wise financial management. Consider also your local government and whether it could raise property taxes for increased school funding if community residents did not approve of the school district's policies and activities.

Most organizations are concerned with legitimacy, as reflected in the annual *Fortune* magazine survey that ranks corporations based on their reputations and the annual Global RepTrak 100 conducted by the Reputation Institute. Success and a good reputation go hand in hand. The fact that there is a payoff for having a good reputation is verified by a study of organizations in the airline industry. Having a good reputation was significantly related to higher levels of performance based on measures such as return on assets and net profit margin.[66]

Many corporations actively shape and manage their reputations to increase their competitive advantage. For example, after the subprime mortgage crisis that began in 2007 and the ensuing financial crisis that led to the failure of giant firms such as Bear Stearns and Lehman Brothers, many companies in the finance industry began searching for new ways to bolster legitimacy. Citigroup, Merrill Lynch, and Wachovia all ousted their chief executives over mortgage-related issues, partly as a way to signal a commitment to better business practices.

The notion of legitimacy answers an important question for institutional theorists: Why is there so much homogeneity in the forms and practices of established organizations? For example, visit banks, high schools, hospitals, government departments, or business firms in a similar industry, in any part of the country, and they will look strikingly similar. When an organizational field is just getting started, such as in Internet-related businesses, diversity is the norm. New organizations fill emerging niches. Once an industry becomes established, however, there is an invisible push toward similarity. *Isomorphism* is the term used to describe this move toward similarity.

5.5a The Institutional View and Organization Design

The institutional view also sees organizations as having two essential dimensions—technical and institutional. The technical dimension is the day-to-day work, technology, and operating requirements. The institutional structure is that part of the

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organization most visible to the outside public. Moreover, the technical dimension is governed by norms of rationality and efficiency, but the institutional dimension is governed by expectations from people and organizations in the external environment. As a result of pressure to conduct business in a proper and correct way, the formal structures of many organizations reflect the expectations and values of the environment rather than the demand of work activities. This means that an organization may incorporate positions or activities (e.g., e-commerce division, chief compliance officer, social media director) perceived as important by the larger society to increase its legitimacy and survival prospects, even though these elements may decrease efficiency. For example, many small companies set up websites, even though the benefits gained from the site are sometimes outweighed by the costs of maintaining it. Having a website is perceived as essential by the larger society today. The formal structure and design of an organization may not be rational with respect to workflow and products or services, but it will ensure survival in the larger environment.

Organizations adapt to the environment by signaling their congruence with the demands and expectations stemming from cultural norms, standards set by professional bodies, funding agencies, and customers. Structure is something of a facade disconnected from technical work through which the organization obtains approval, legitimacy, and continuing support. The adoption of structures thus might not be linked to actual production needs and might occur regardless of whether specific internal problems are solved. Formal structure is separated from technical action in this view.[67]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Pursue legitimacy with your organization's major stakeholders in the external environment. Adopt strategies, structures, and management techniques that meet the expectations of significant parties, thereby ensuring their cooperation and access to resources.

5.5b Institutional Similarity

Many aspects of structure and behavior may be targeted toward environmental acceptance rather than toward internal technical efficiency. Interorganizational relationships thus are characterized by forces that cause organizations in a similar population to look like one another. **Institutional similarity**, called *institutional isomorphism* in the academic literature, is the emergence of a common structure and approach among organizations in the same field. Isomorphism is the process that causes one unit in a population to resemble other units that face the same set of environmental conditions.[68]

Exactly how does increasing similarity occur? How are these forces realized? Exhibit 5.6 provides a summary of three mechanisms for institutional adaptation. These three core mechanisms are *mimetic forces*, which result from responses to uncertainty; *coercive forces*, which stem from political influence; and *normative forces*, which result from common training and professionalism.[69]

Mimetic Forces. Most organizations, especially business organizations, face great uncertainty. It is not clear to senior executives exactly what products, services, technologies, or management practices will achieve desired goals, and sometimes the goals themselves are not clear. In the face of this uncertainty, **mimetic forces**, the pressures to copy or model other organizations, occur. Executives observe an innovation in a firm generally regarded as successful, so the practice is quickly copied. McDonald's revived stagnant sales by adding healthier menu items and new types of beverages, so other fast-food chains began doing the same. "You need to learn from your competition," said David Novak, CEO of Yum Brands, the parent company of KFC, Taco Bell, and Pizza Hut. Similarly, the three largest U.S. airlines—American,

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EXHIBIT 5.6
Three Mechanisms for Institutional Adaptation

	Mimetic	Coercive	Normative
Reason to become similar:	Uncertainty	Dependence	Duty, obligation
Events:	Innovation visibility	Political—law, rules, sanctions	Professionalism—certification, accreditation
Social basis:	Culturally supported	Legal	Moral
Example:	Reengineering, benchmarking	Pollution controls, school regulations	Accounting standards, consultant training

Source: Adapted from W. Richard Scott, *Institutions and Organizations* (Thousand Oaks, CA: Sage, 1995).

Delta, and United—routinely copy one another. When United announced lie-flat beds on cross-country routes, American and Delta quickly followed suit. Delta was the first to provide its top customers luxury car rides across the tarmac at major hub airports, and the other two were soon doing the same. All three now use the same formula for awarding frequent flier miles, basing awards on ticket price rather than distance flown.[70] Many large companies enter specific foreign markets when managers see their firm's biggest rivals doing so, even if entering the market is highly risky. Managers don't want to take a chance on losing out.[71]

Many times, this modeling of other organizations is done without any clear proof that performance will be improved. Mimetic processes explain why fads and fashions occur in the business world. Once a new idea starts, many organizations grab onto it, only to learn that the application is difficult and may cause more problems than it solves. One example is the proliferation of corporate wellness programs. Many corporations jumped on board to the tune of an annual $50 billion globally. However, recent survey evidence suggests that employee health has not improved as a result. Each employer wants to signal that it, too, is enlightened, but most companies are not measuring whether the wellness programs actually make a difference.[72]

Techniques such as outsourcing, teams, Six Sigma quality programs, brainstorming, and the balanced scorecard have all been adopted without clear evidence that they will improve efficiency or effectiveness. The one certain benefit is that management's feelings of uncertainty will be reduced, and the company's image will be enhanced because the firm is seen as using the latest management techniques. A study of 100 organizations confirmed that those companies associated with using popular management techniques were more admired and rated higher in quality of management, even though these organizations often did not reflect higher economic performance.[73] Perhaps the clearest example of official copying is the technique of benchmarking that occurs as part of the total quality movement. *Benchmarking* means identifying who is best at something in an industry and then duplicating the technique for creating excellence, perhaps even improving it in the process. Many organizations, however, simply copy what a competitor is doing without understanding why it is successful or how it might mesh—or clash—with their own organization's way of doing business.[74]

The mimetic process occurs because managers face high uncertainty, they are aware of innovations occurring in the environment, and the innovations are culturally supported, thereby giving legitimacy to adopters. This is a strong mechanism by which a group of banks, or high schools, or manufacturing firms begin to look and act like one another.

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ASSESS YOUR ANSWER

3 Managers should quickly copy or borrow techniques being used by other successful companies to make their own organization more effective and to keep pace with changing times.

ANSWER: *Agree.* Managers frequently copy techniques used by other, successful organizations as a way to appear legitimate and up to date. Copying other firms is one reason organizations may begin to look and act similar in their structures, processes, and management systems.

Coercive Forces. All organizations are subject to pressure, both formal and informal, from government, regulatory agencies, and other important organizations in the environment, especially those on which a company is dependent. **Coercive forces** are the external pressures exerted on an organization to adopt structures, techniques, or behaviors similar to other organizations. For example, corporations have been putting pressure on service providers, such as accounting or law firms, to step up their diversity efforts. Managers in these corporations have felt pressure to increase diversity within their own organizations and they want the firms with which they do business to reflect a commitment to hiring and promoting more women and minorities as well. Facebook began requiring that women and ethnic minorities make up at least 33 percent of law firm teams that work on legal issues for the social media giant.[75]

Some pressures may have the force of law, such as government mandates to adopt new pollution control equipment or new safety standards. New regulations and government oversight boards were set up for the mortgage and finance industries following the 2008 Wall Street meltdown. As one example, the Credit Card Accountability, Responsibility, and Disclosure (CARD) Act requires credit card companies to add specific warnings regarding late payments and the total amount of interest customers will pay if they make only the minimum payment.

Coercive pressures may also occur between organizations where there is a power difference, as described in the resource-dependence section earlier in this chapter. Large retailers and manufacturers often insist that certain policies, procedures, and techniques be used by their suppliers. As part of its new sustainability push, for instance, Walmart began requiring some of the giant retailer's 100,000 or so suppliers to calculate the "full environmental costs" of making their products (such as water use, carbon dioxide emissions, and waste) and provide this information for the company to distill into a rating system that shoppers will see alongside the price of the item. Microsoft requires its major suppliers and contractors to provide paid sick leave, vacation time, and family leave for employees that work on Microsoft projects.[76]

As with other changes, those brought about because of coercive forces may not make the organization more effective, but it will look more effective and will be accepted as legitimate in the environment. Organizational changes that result from coercive forces occur when an organization is dependent on another, when there are political factors such as rules, laws, and sanctions involved, or when some other contractual or legal basis defines the relationship. Organizations operating under those constraints will adopt changes and relate to one another in a way that increases homogeneity and limits variety.

BRIEFCASE

As an organization manager, keep this guideline in mind:

Enhance legitimacy by borrowing good ideas from other firms, complying with laws and regulations, and following procedures considered best for your company.

Normative Forces. The third reason organizations change according to the institutional view is normative forces. **Normative forces** are pressures to achieve standards of professionalism and to adopt techniques that are considered by the professional community to be up to date and effective. Changes may be in any area, such as

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information technology, accounting requirements, marketing techniques, or collaborative relationships with other organizations.

Professionals share a body of formal education based on university degrees and professional networks through which ideas are exchanged by consultants and professional leaders. Universities, consulting firms, trade associations, and professional training institutions develop norms among professional managers. People are exposed to similar training and standards and adopt shared values, which are implemented in organizations with which they work. Business schools teach finance, marketing, and human resource majors that certain techniques are better than others, so using those techniques becomes a standard in the field. In one study, for example, a radio station changed from a functional to a multidivisional structure because a consultant recommended it as a "higher standard" of doing business. There was no proof that this structure was better, but the radio station wanted legitimacy and to be perceived as fully professional and up to date in its management techniques.

Companies accept normative pressures to become like one another through a sense of obligation or duty to high standards of performance based on professional norms shared by managers and specialists in their respective organizations. These norms are conveyed through professional education and certification and have almost an ethical tone based on the highest standards accepted by the profession at that time. In some cases, though, normative forces that maintain legitimacy break down, and coercive forces are needed to shift organizations back toward acceptable standards.

An organization may use any or all of the mechanisms of mimetic, coercive, or normative forces to change itself for greater legitimacy in the institutional environment. Firms tend to use these mechanisms when they are acting under conditions of dependence, uncertainty, ambiguous goals, and reliance on professional credentials. The outcome of these processes is that organizations become far more homogeneous than would be expected from the natural diversity among managers and environments.

REMEMBER THIS

- The institutional perspective argues that interorganizational relationships are shaped as much by a company's need for legitimacy as by the need to provide products and services.
- The need for legitimacy means that the organization will adopt structures and activities that are perceived by external stakeholders as valid, proper, and up to date. In this way, established organizations copy techniques from one another and begin to look very similar.
- The emergence of common structures and approaches in the same field is called institutional similarity or institutional isomorphism.
- Three core mechanisms explain increasing organizational homogeneity: mimetic forces, which result from responses to uncertainty; coercive forces, which stem from power differences and political influences; and normative forces, which result from common training and professionalism.

Each of the four perspectives described in this chapter is valid. They represent different lenses through which the world of interorganizational relationships can be viewed: organizations experience a competitive struggle for autonomy; they can thrive through collaborative relationships with others; the slowness to adapt provides openings for new organizations to flourish; and organizations seek legitimacy as well as profits from the external environment. The important thing is for managers to be aware of interorganizational relationships and to consciously manage them.

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KEY CONCEPTS

coercive forces
collaborative-network perspective
generalist
institutional environment
institutional perspective
institutional similarity
interorganizational relationships
joint venture
legitimacy
mimetic forces
niche
normative forces
organizational ecosystem
organizational form
population
population-ecology perspective
resource-dependence theory
retention
selection
specialist
strategic alliance
struggle for existence
trade association
variation

DISCUSSION QUESTIONS

1. The concept of business ecosystems implies that organizations are more interdependent than ever before. From personal experience, do you agree? Explain.
2. How do you feel about the prospect of becoming a manager and having to manage a set of relationships with other companies rather than just managing your own company? Discuss.
3. Assume you are the manager of a small firm that is dependent on a large manufacturing customer that uses the resource-dependence perspective. Put yourself in the position of the small firm, and describe what actions you would take to survive and succeed. What actions would you take from the perspective of the large firm?
4. Many managers today were trained under assumptions of adversarial relationships with other companies. Do you think operating as adversaries is easier or more difficult than operating as partners with other companies? Discuss.
5. Discuss how the adversarial versus partnership orientations work between you and other students in your course. Is there a sense of competition or collaboration for grades? Is it possible to develop true partnerships if your grade depends on the work of others? Explain.
6. The population-ecology perspective argues that it is healthy for society to have new organizations emerging and old organizations dying as the environment changes. Do you agree? Why would European countries pass laws to sustain traditional organizations and inhibit the emergence of new ones?
7. Discuss how the process of variation, selection, and retention might help explain innovations that take place within an organization.
8. Do you believe that perceived legitimacy really motivates a large, powerful organization such as Walmart? Is acceptance by other people a motivation for individuals as well? Explain.
9. How does the desire for legitimacy result in organizations becoming more similar over time?
10. How do mimetic forces differ from normative forces? Give an example of each.

CHAPTER 5 WORKSHOP The Shamatosi[77]

Instructions

1. Divide into groups of three. Half the groups, on one side of the room, are "1s" and the other half are "2s."
2. The 1s are Pharmacology; the 2s are Radiology. Read *only* your own role, not the other one.
3. Any students not in a negotiating group can be assigned to observe a specific negotiation meeting.
4. Both groups want to purchase Shamatosi plants owned by DBR.
5. Each group has 10 minutes to prepare a negotiation strategy for meeting with the other side.
6. One Pharmacology group meets with one Radiology group so that all groups meet with one counterpart.
7. You have 15 minutes to try and negotiate a possible agreement to purchase Shamatosi plants from DBR.
8. You should decide whether you can form an agreement to move ahead jointly or whether you will go into competition with each other. An agreement would consider the price offered for the plants, how the cost is shared, to where plants will be delivered (which company), and how plants are best utilized.
9. Groups report to the whole class on results of negotiation. Observers can comment on their observations, such as level of trust and/or disclosure and ease/difficulties of reaching an agreement between companies.
10. Instructor leads a discussion on interorganizational agreements, decision-making, and joint ventures.

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Role of Team from Pharmacology, Inc.:

Dr. Bernice Hobbs, a biological researcher for Pharmacology, Inc., a major pharmaceutical company, has monitored with mounting concern the reports from Brazil's Amazon rainforest. Everything from world weather patterns to providing an estimated one in four ingredients in medicine is tied to securing the world's rainforests. But over the past decade, scientists and pharmaceutical companies, along with environmental groups and others, have observed with alarm the destruction of the rainforests, and with it the destruction of entire species of plant, animal, and insect life.

As Hobbs monitors the situation, she is particularly concerned about conditions with regard to a particular plant found in limited quantities near the Rio Negro. Rainforest trees have shallow roots because the major nutrients for growth are located near the surface level. Biologists discovered a rare tiny plant growth called Shamatosi embedded among the trees near the Rio Negro. For a number of years, researchers have explored potential medical uses for these tiny plants.

Dr. Hobbs has been working with the leaves of the tiny Shamatosi plant and has discovered the plant's potential as a cancer-suppressing drug after breast cancer surgery. For a number of years, the leading drug in this category has been Tamoxifen, a synthetic drug described as "remarkable" and credited with saving more lives than any other oncological drug by the lead investigator for a major breast cancer research group. However, research has also shown that Tamoxifen raises the risk of cancer in the lining of the uterus and can lead to blood clots in the lungs. There is also a growing level of concern as Tamoxifen resistance has developed. The medicine developed by Hobbs may avoid these problems and bring a new treatment into the list of options for doctors and their patients. But more research is needed. Hobbs needs to have access to as many leaves as possible from the Shamatosi plant.

DBR, the Brazilian timber company, has possession of several thousand Shamatosi plants from this year's season that have been replanted in portable crates. Your company, Pharmacology, Inc., has authorized $1.5 million for your team to bid to obtain the plants. You cannot go over this budget. Your team will meet with a team from Radiology, Inc., which also wants to purchase the Shamatosi plants from DBR, about a possible agreement for purchasing and using the plants for research.

Role of Team from Radiology, Inc.:

Dr. Alberto Dominguez, a biochemist for Radiology, Inc. who has expertise in treating radiation exposure, monitors with mounting concern the reports from Brazil's Amazon rainforest. Everything from world weather patterns to providing an estimated one in four ingredients in medicine is tied to securing the world's rainforests. But over the past decade, scientists and pharmaceutical companies, along with environmental groups and others, have observed with alarm the destruction of the rainforests, and with it the destruction of entire species of plant, animal, and insect life.

As Dominguez monitors the situation, he is particularly concerned about conditions concerning a particular plant found in limited quantities near the Rio Negro. Rainforest trees have shallow roots because the major nutrients for growth are located near the surface level. Biologists discovered a rare tiny plant growth called Shamatosi embedded among the trees near the Rio Negro. For a number of years, researchers have explored potential medical uses for these tiny plants.

Dr. Dominquez has been working with the roots of the Shamatosi plant in response to incidents involving radiation exposure. The worldwide expansion of nuclear facilities, the lessons from the 1986 Chernobyl disaster, and the resulting cases of thyroid cancer among thousands of children and adolescents, led to intensive research by Dominguez and his colleagues to provide the swiftest response with the most powerful medicine. For years, Potassium iodide (KI) was issued in kits provided by organizations such as the Centers for Disease Control. However, KI was found deficient in protecting many body parts, such as the liver and intestines. Dominguez discovered the tiny Shamatosi plant, and his research indicated the potential for medicines from the root of this plant to provide additional protection, even for incidents of large-scale or prolonged exposure. The March 2011 Tohoku earthquake and tsunami, and the resultant radiation exposure caused by the meltdown at the Fukushima Daiichi nuclear power plant, intensified concerns among scientists to find and develop a new medicine. Dominguez needs as many plants as possible.

DBR, the Brazilian timber company, has possession of several thousand Shamatosi plants from this year's season that have been replanted in portable crates. Your company, Radiology, Inc., has authorized your team to bid $1.5 million to obtain the plants. You cannot go over this budget. Your team will meet with a team from Pharmacology, Inc., which also wants to purchase the Shamatosi plants from DBR, about a possible agreement for purchasing and using the plants for research.

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CASE FOR ANALYSIS | Technomagia and AUD

Vito Brassimo immigrated to the United States six years ago after working as design leader for an Italian company specializing in home sound systems. Armed with a vision and 15 years of experience, he founded his own company, Technomagia, as the supplier of sound translation components including the base radiator, dome tweeter (for high frequency), composite cone (for midrange sound), the binding post (for sound translator delivery), and ohms impedance (for conducting sound through the speakers). As it builds its reputation for quality and supply chain service and delivery, Technomagia relies heavily on continuing a solid relationship with AUD, a manufacturer of home sound systems, under the management of CEO Martin Right. AUD was the company's first contractual partner, currently accounting for 50 percent of the small supplier's business. The initial agreement with AUD has grown and the current business relationship brings a steady stream of orders that has enabled Brassimo, even in a tough economy, to add workers over the last three years. Brassimo loves the reliability of selling to AUD, but he sometimes questions whether the business relationship is overbalanced in favor of the powerful manufacturer.

"I think in the beginning Right played his hand well, knowing that we were a startup and trying to secure a solid customer base. In my eagerness to get the contract and in trying to please the head of a big company, I found myself saying 'Yes' and carrying out his wishes and demands," Brassimo admits. "Because we were a young company and because he is, by far, our biggest customer, I think he got into the habit of assuming the focus would remain on *his* needs and *his* profits throughout the business relationship. But now, with our feet under us as a company, I think it is time to look again at the relationship between the two companies."

Right is satisfied with the present arrangement he has with Technomagia and sees himself as both partner and mentor, as he recently explained to a colleague. "Brassimo came to this country and started his company and I was willing to give him a chance, set up our logistics, and make it possible for him to grow his company. I think it's worked out very well for AUD. And now he talks about wanting to change the way we do things. I'm suspicious about what he has in mind. But he needs us more than we need him. Look, I've got a good supplier; he gets lots of business from us; I see no reason to change it."

Although the relationship and dialogue at the top management level is strained, mid-level managers at both companies *do* talk and are eager to explore and implement a new vendor managed inventory (VMI) system that builds a partnership of strong interdependence and equity. Instead of sending purchase orders, VMI involves sharing daily electronic information about AUD's sales, so inventory is replaced automatically by Technomagia. Mid-level managers Gary Handell (AUD) and Victoria Santos (Technomagia) regularly correspond and meet to find potential areas for close cooperation, information sharing, and problem feedback.

"I know that Right is suspicious, but it really is time for these two guys to take a new look at this business relationship and how they can address issues that could be beneficial to both," Santos says. "The playing field has changed. Technomagia is stronger."

"But the relationship has not changed and I don't think it will until Brassimo finds a way to reduce his dependence on AUD. In the meantime, flexibility, information sharing, and reconsidering a range of cost-efficient options is important," Handell admits, "But we have to start with the discussion of whether AUD calls all the shots between our two organizations."

"Yes, and that discussion must include logistical issues," Santos says.

"Delivery, the disagreements about the pallets . . ."

"Right set up all of that initially—what would work best for delivery to AUD," Santos says. "But Brassimo insists that PM rather than AM pick-ups would be better and that a change in pallet companies, from Bradley Packaging to Eastmont Packaging, would cut costs per trip by reducing mileage. Plus, Eastmont has a new custom-made pallet that provides greater load stabilization necessary for high-tech components. The savings for Technomagia would be shared with AUD."

"But Bradley has a long-time business relationship of its own with AUD," Handell points out.

"So, what we're saying here is that it is not *just* a discussion about these two organizations, but a consideration of the whole supply chain. The cost of lost flexibility, the lack of shared information. It's costing both of them. And the sudden spikes in production requests by AUD, in response to its retail customers, create unnecessary problems in production planning at Technomagia and unnecessary stress for the management and workers at both companies."

"VMI could be a powerful tool that empowers and brings value to both sides," Handell says. "Through this system, Technomagia will be able to create orders for us based on direct access to our orders and demand information—both short and long-range needs . . ."

"And then, we can work together, determining the most cost-efficient way to manage and deliver the inventory," Santos continues. "We'll look at the entire supply chain to see where changes and even minor tweaks can be made to bring down costs and make the partnership strong, but there would have to be equal give and take."

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"Flexibility on both sides is necessary to make this work," Handell points out. "This is not a competition. Nobody has to be *right*."

"But getting top management on board to make this work is our real challenge," Santos says. "And we have to start looking ahead. VMI could be a stepping-stone to Jointly Managed Inventory (JMI), an even deeper collaboration, allowing the increased tactical planning and the real integration of Technomagia and AUD's point of sale systems. That will offer optimal cost sharing and real time sales data, allowing us to stay ahead of the curve in production planning as well as logistics to meet AUD's needs in real time."

"So, what's our next step?" Handell asks. "How can we make this happen?"

Questions

1. What is the role of the resource dependence and collaborative network perspectives in this case? Explain your reasoning.
2. Do you think the relationship between Technomagia and AUD would have worked out satisfactorily for both without VMI? Discuss your expected outcomes with and without VMI.
3. Why do think Brassimo and Right have different perspectives on the need for a change in the relationship between their businesses?

CASE FOR ANALYSIS | Bradford Chemicals Company[78]

Bradford Chemicals manufactures high-quality plastics and resins for use in a variety of products, from lawn ornaments and patio furniture to automobiles. The Bradford plant located near Beatty, a town of about 45,000 in a South-eastern state, employs about 3,000 workers. It plays an important role in the local economy and, indeed, that of the entire state, which offers few well-paying factory jobs.

In early 2004, Sam Henderson, plant manager of the Beatty facility, notified Governor Tom Winchell that Bradford was ready to announce plans for a major addition to the factory—a state-of-the-art color lab and paint shop that would enable better and faster matching of colors to customer requirements. The new shop would keep Bradford competitive in the fast-paced global market for plastics, as well as bring the Beatty plant into full compliance with updated U.S. Environmental Protection Agency (EPA) regulations.

Plans for the new facility were largely complete. The biggest remaining task was identifying the specific location. The new color lab and paint shop would cover approximately 25 acres, requiring Bradford to purchase some additional land adjacent to its 75-acre factory campus. Henderson was somewhat concerned with top management's preferred site because it fell outside the current industrial zoning boundary, and, moreover, would necessitate destruction of several 400- to 500-year-old beech trees. The owner of the property, a nonprofit agency, was ready to sell, whereas property located on the other side of the campus might be more difficult to obtain in a timely manner. Bradford was on a tight schedule to get the project completed. If the new facility wasn't up and running in a timely manner, there was a chance the EPA could force Bradford to stop using its old process—in effect, shutting down the factory.

The governor was thrilled with Bradford's decision to build the new shop in Beatty and he urged Henderson to immediately begin working closely with local and state officials to circumvent any potential problems. It was essential, he stressed, that the project not be bogged down or thwarted by conflict among different interest groups, as it was too important to the economic development of the region. Governor Winchell assigned Beth Friedlander, director of the Governor's Office of Economic Development, to work closely with Henderson on the project. However, Winchell was not willing to offer his commitment to help push through the rezoning, as he had been an enthusiastic public supporter of environmental causes.

Following his conversation with Governor Winchell, Henderson sat down to identify the various people and organizations that would have an interest in the new color lab project and that would need to collaborate in order for it to proceed in a smooth and timely manner. They are as follows:

Bradford Chemicals

- Mark Thomas, vice president of North American Operations. Thomas would be flying in from Bradford's Michigan headquarters to oversee land purchase and negotiations regarding the expansion.
- Sam Henderson, Beatty plant manager, who has spent his entire career at the Beatty facility, beginning on the factory floor fresh out of high school.
- Wayne Talbert, local union president. The union is strongly in favor of the new shop being located in Beatty because of the potential for more and higher-wage jobs.

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State Government

- Governor Tom Winchell, who can exert pressure on local officials to support the project.
- Beth Friedlander, director of the Governor's Office of Economic Development.
- Manu Gottlieb, director of the State Department of Environmental Quality.

City Government

- Mayor Barbara Ott, a political newcomer who has been in office for less than a year and who campaigned on environmental issues.
- Major J. Washington, the Chamber of Commerce chair of local economic development.

Public

- May Pinelas, chairman of Historic Beatty who argues vociferously that the future of the region lies in historic and natural preservation and tourism.
- Tommy Tompkins, president of the Save Our Future Foundation, a coalition of private individuals and representatives from the local university who have long been involved in public environmental issues and have successfully thwarted at least one previous expansion project.

Henderson is feeling torn about how to proceed. He thinks to himself, "To move forward, how will I build a coalition among these diverse organizations and groups?" He understands the need for Bradford to move quickly, but he wants Bradford to have a good relationship with the people and organizations that will surely oppose destruction of more of Beatty's natural beauty. Henderson has always liked finding a win-win compromise, but there are so many groups with an interest in this project that he's not sure where to start. Maybe he should begin by working closely with Beth Friedlander from the governor's office—there's no doubt this is an extremely important project for the state's economic development. On the other hand, it's the local people who are going to be most affected and most involved in the final decisions. Bradford's vice president has suggested a press conference to announce the new shop at the end of the week, but Henderson is worried about putting the news out cold. Perhaps he should call a meeting of interested parties now and let everyone get their feelings out into the open? He knows it could get emotional, but he wonders if things won't get much uglier later on if he doesn't.

Questions

1. Do you think it is necessary for Henderson to meet with and try to build support from such a diverse group of people before moving ahead with the color lab and paint shop? Why?
2. How does the institutional view in the chapter help explain the events in this case? Discuss.
3. Which of normative or coercive forces among stakeholders do you think are more likely to affect the decision to build the color lab and paint shop? Why?

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CHAPTER

6 Designing Organizations for the International Environment

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Learning Objectives

After reading this chapter you should be able to:

1. Compare and contrast the three primary motivations for entering the global arena.
2. Explain the three major challenges global design faces.
3. Define globalization, multidomestic, and glocalization strategies.
4. Describe how different structural design options for international operations relate to differences in global strategy.
5. Identify mechanisms for global coordination, knowledge transfer, and resolving the tension between global uniformity and local responsiveness.
6. Describe the transnational model of organizing.

Chapter Outline

Entering the Global Arena

Motivations for Global Expansion · Managing the Stages of International Development · Global Expansion Through International Alliances and Acquisitions

The Challenges of Global Design

Increased Complexity and Differentiation · Increased Need for Coordination · Transfer of Knowledge and Reverse Innovation

Designing Structure to Fit Global Strategy

Strategies for Global Versus Local Opportunities · International Division · Global Product Division Structure · Global Geographic Division Structure · Global Matrix Structure

Additional Global Coordination Mechanisms

Global Teams · Headquarters Planning · Expanded Coordination Roles · Benefits of Coordination

The Transnational Model of Organization

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **The only way an organization can reasonably expect to be successful in different countries is to customize its products and services to suit the local interests, preferences, and values in each country.**

I AGREE _____ **I DISAGREE** _____

2 **It is an especially difficult challenge to work on a global team to coordinate one's own activities and share new ideas and insights with colleagues in different divisions around the world.**

I AGREE _____ **I DISAGREE** _____

3 **The most advanced multinational corporations have developed systems for maintaining tight headquarters control over subsidiaries in dozens of countries.**

I AGREE _____ **I DISAGREE** _____

Walmart is the world's largest retailer, but company managers have learned some hard lessons in trying to expand internationally. When sales started to decline in the United States, Walmart looked to Germany, where the economy was booming. It bought out two local retailers, giving it 95 ready-made locations, then rapidly renovated the stores and set about implementing Walmart's proven methods for distribution, supply chain, and other operations. That's when the problems started. Germany has a law prohibiting merchants from selling products below cost, eliminating one of Walmart's key competitive strategies. The Walmart shopping experience, with employees enthusiastically greeting shoppers at the door and offering help every 10 feet, irritated German customers. Some customers were also offended by the grocery bagging because Germans don't like strangers handling their food. Walmart employees weren't happy either. Mandatory morning calisthenics and chants of Walmart! Walmart! Walmart! went down like the proverbial lead balloon. Walmart insisted on smiling clerks, but in Germany this was interpreted as flirting. After nine years of struggling to make the Walmart way work in Germany, the company sold its stores to local rival Metro and left the country. As a Canadian radio station reported, the story shows how "even the most successful retailer in the world can trip across a border."[1]

That's the reality of international business. When an organization decides to do business in another country, managers face a whole new set of challenges and roadblocks. They sometimes find that transferring their domestic success internationally requires a totally different approach. When Klaus Gehrig, CEO of German grocery chain Lidl, was asked about the company's entry into the U.S. market, he called it a "catastrophe."[2] Tesco, a thriving grocery retailer in the United Kingdom, expected to find the same success in the United States, but after five years and a cost of $1.6 billion, managers closed or sold all of Tesco's U.S. markets, which never turned a profit.[3]

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Companies in other industries have also stumbled in the international arena. Despite its size and power, Amazon has struggled in the Chinese market against competitors such as China's Kaola and Alibaba Group Holding's e-commerce platforms that better understand the local market and regulatory environment. In early 2019, Amazon announced that it would shut down its third-party online marketplace and no longer provide seller services on its Chinese website.[4] Deere & Company, the world's largest maker of farm equipment, has been trying hard to penetrate Russia's farm equipment market. Because of a new law excluding farm machinery built outside the country from financing, Deere opened a plant near Moscow but it still faces tremendous risks and uncertainties in Russia.[5] Large, powerful technology companies such as Google and Facebook are tackling a growing backlash from citizens, governments, and politicians around the world. These companies have grown at unprecedented rates and reach into people's lives more than other types of companies going global. In the European Union, efforts to prevent large tech companies from using their power to squash competition resulted in a $5 billion fine against Google. The EU is also looking at whether Amazon unfairly uses data from retailers that sell on its platform.[6]

Succeeding on a global scale isn't easy. Managers have to make tough decisions about strategic approach, how best to get involved in international markets, and how to design the organization to reap the benefits of international expansion. Despite the challenges, managers in most organizations think the potential rewards outweigh the risks. U.S.-based firms set up foreign operations to provide goods and services needed by consumers in other countries, as well as to obtain lower costs or technical know-how for producing products and services to sell domestically. In return, companies from Japan, Germany, China, the United Kingdom, and other countries compete with U.S. organizations on their own turf as well as abroad. Understanding and addressing the challenges of international business is more important today than ever before.

Purpose of This Chapter

This chapter explores how managers design an organization for the international environment. We begin by looking at some of the primary motivations for organizations to expand internationally, the typical stages of international development, the need for cultural intelligence, and the use of alliances and acquisitions as ways to expand internationally. Then, the chapter discusses some of the specific design challenges global organizations face, examines global strategic approaches, considers the application of various structural designs for global advantage, and looks at coordination mechanisms used in global organizations. Finally, the chapter takes a look at the *transnational model,* a type of global organization that achieves high levels of the varied capabilities needed to succeed in a complex and volatile international environment.

6.1 Entering the Global Arena

Only a few decades ago, many companies could afford to ignore the international environment. Not today. The world is rapidly developing into a unified global field, and every company and manager needs to think globally. Brazil, Russia, India, and China (often referred to as BRIC) as well as other emerging economies, are growing rapidly as providers of both products and services to the United States, Canada, Europe, and other developed nations. At the same time, these regions are becoming major markets for the products and services of North American firms.[7] A report

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from research firm eMarketer indicated that China, with the fastest-growing middle class in history, would overtake the United States in 2019 as the world's largest retail market. The country is already the largest market for automobiles and smartphones, and even with the slowing economy still represents a huge market for consumer goods, jewelry, and other luxury goods.[8]

Over the next few decades, the BRIC countries will have tremendous spending power as around a billion people become part of a new middle class.[9] For today's companies, the whole world is a source of business threats and opportunities. The BookMark discusses some of the factors contributing to our increasingly interconnected world and how this interconnection affects organizations.

6.1a Motivations for Global Expansion

Economic, technological, and competitive forces have combined to push many companies from a domestic to a global focus. Extraordinary advances in communications, technology, and transportation have created a new, highly competitive landscape.[10]

BOOKMARK 6.0 HAVE YOU READ THIS BOOK?

The World Is Flat: A Brief History of the Twenty-First Century

By Thomas L. Friedman

The global competitive playing field is being leveled. How fast is globalization happening? Three-time Pulitzer-Prize-winning *New York Times* columnist Thomas L. Friedman started working on the second edition of his best-selling book, *The World Is Flat,* before the first edition was barely off the press. However, Friedman asserts that the forces causing this accelerated phase of globalization actually began to unfold in the final years of the twentieth century.

WHAT MAKES THE WORLD GO FLAT?

Friedman outlines 10 forces that flattened the world, which he calls flatteners. Many of these forces are directly or indirectly related to advanced technology, including the following:

- *Work flow software.* A dizzying array of software programs enable computers to easily communicate with one another. That's what makes it possible for a company like animation studio Wild Brain to make films with a team of production employees spread all over the world or for Boeing airplane factories to automatically resupply global customers with parts. It means companies can create global virtual offices as well as outsource pieces of their operations to whoever can do the job best and most efficiently, no matter in which country they are located.
- *Supply chaining.* Work flow software also enhances supply chaining, the horizontal collaboration among suppliers, retailers, and customers that became a phenomenon in the 1990s. In turn, the more supply chains grow and proliferate, the flatter the world becomes. Supply chaining forces the adoption of common standards and technologies among companies so that every link can interact seamlessly.
- *The steroids.* Friedman refers to a variety of new technologies as steroids "because they are amplifying and turbocharging all the other flatteners." Perhaps the most significant element is the wireless revolution, which enables you to "take everything that has been digitized, made virtual and personal, and do it from anywhere." As Alan Cohen, senior vice president at Airespace, says, "Your desk goes with you everywhere you are now. And the more people have the ability to push and pull information from anywhere to anywhere faster, the more barriers to competition and communication disappear."

HOW TO BENEFIT FROM A FLATTER WORLD

A flatter, interconnected world means employees and organizations can collaborate and compete more successfully than ever, whatever their size and wherever they are located. But the benefits of a flatter world are not automatic. Friedman offers strategies for how companies can align themselves with the new reality of globalization. He warns U.S. companies (and employees) that they should embrace the idea that there will no longer be such a thing as an American firm or an American job. In a flat world, the best companies are the best global collaborators.

The World Is Flat, by Thomas L. Friedman, is published by Farrar, Straus & Giroux.

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The importance of the global environment for today's organizations is reflected in the shifting global economy. As one indication, *Fortune* magazine's list of the Global 500, the world's 500 largest companies by revenue, indicates that economic clout is being diffused across a broad global scale. Exhibit 6.1 lists the 10 countries with the largest number of companies on the Global 500 in 2017, comparing the number of companies in 2006, 2013, and 2017. Note the general decline in the United States and Western Europe and the dramatic increase in China. China's GDP surpassed Japan's in the second half of 2010, making that country the second-largest economy in the world (after the United States). In 2017, three of the top five largest companies by revenue were Chinese corporations.[11] Consider that in 1993, China had only three companies on the *Fortune* Global 500 list and now has 111.[12]

As power continues to shift, organizations are viewing participation in global business as a necessity. Indeed, in some industries a company can be successful only by succeeding on a global scale. In general, three primary factors motivate companies to expand internationally: economies of scale, economies of scope, and low-cost production factors.[13] Recall from Chapter 2 that companies are always striving for greater efficiency and effectiveness. Expanding globally is one way to achieve these goals.

Economies of Scale. Building a global presence expands an organization's scale of operations, enabling it to realize **economies of scale**. The trend toward large organizations was initially sparked by the Industrial Revolution, which created pressure in many industries for larger factories that could seize the benefits of economies of scale offered by new technologies and production methods. Through large-volume production, these industrial giants were able to achieve the lowest possible cost per unit of production. However, for many companies, domestic markets no longer provide the high level of sales needed to maintain enough volume to achieve scale economies. For farm equipment manufacturers such as Deere & Company, for example, growth comes primarily from overseas, where more land is coming under cultivation and more farmers are mechanizing. Most farm equipment in North America is relatively new, according to a recent report on the farm machinery market. "While there could be some growth left [in North America], we're nearer to the peak than the trough," said the report. Deere is looking to the BRIC countries to lift sales outside the United States so the company can achieve scale economies.[14]

EXHIBIT 6.1
The Shifting Global Economy as Reflected in the *Fortune* Global 500

	Number of Companies on the Global 500 List		
	2006	2013	2017
United States	170	132	126
China	20	89	111
Japan	70	62	52
Germany	35	29	32
France	38	31	28
Britain	38	26	20
South Korea	12	2	16
Netherlands	14	11	15
Switzerland	12	14	14
Canada	14	9	12

Source: Based on data from "Global 500," *Fortune* magazine's annual ranking of the world's largest corporations for 2006 and 2013, http://money.cnn.com/magazines/fortune/global500/ (accessed December 7, 2011, and March 14, 2014); and "Fortune Global 500: The List," *Fortune*, August 1, 2018, F1–F8.

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The Hollywood movie industry has also recently expanded its international outlook as sales of movie tickets have declined in the United States and increased in other countries. Sales of tickets at U.S. movie theaters fell to record lows in 2017 but growth in other markets, particularly China, gave the industry a record high of $40.6 billion.[15] The studios are using more international stars and retooling scripts to appeal to an international audience. One film industry veteran said, "No studio head is going to make a big expensive movie . . . unless it has worldwide appeal. You can't pay back that production cost on the domestic model alone."[16] International ticket sales now account for up to 80 percent of a movie's total gross.[17]

Domestic markets have become saturated for many U.S. companies, and the only potential for growth lies overseas. Starbucks has targeted Asia for rapid international growth and has opened more than 8,500 stores in China, Japan, South Korea, Taiwan, and other countries. CEO Kevin Johnson says China is the company's second-largest market after the United States. To show its commitment to China, the company opened its largest Starbucks store by size, at 37,000 square feet, in Shanghai in 2017.[18] Economies of scale also enable companies to obtain volume discounts from suppliers, lowering the organization's cost of production.

BRIEFCASE

As an organization manager, keep this guideline in mind:

Consider building an international presence to realize economies of scale, exploit economies of scope, or obtain scarce or low-cost production factors such as labor and raw materials.

Economies of Scope. A second factor is the enhanced potential for exploiting **economies of scope**. *Scope* refers to the number and variety of products and services a company offers as well as the number and variety of regions, countries, and markets it serves. Hollywood's DreamWorks SKG sold a 50 percent stake to India's Reliance Big Entertainment because the company has a presence in every entertainment platform. It can sell DreamWorks movies through its theaters, its satellite networks, its movie rental service, its radio stations, and its mobile phones.[19]

Companies that have a presence in multiple countries gain marketing power and synergy compared to the same-size firm that has a presence in fewer countries. For example, an advertising agency with a presence in several global markets gains a competitive edge serving large companies that span the globe. Or consider the case of McDonald's, which has to obtain nearly identical ketchup and sauce packets for its restaurants around the world. A supplier that has a presence in every country McDonald's serves has an advantage because it provides cost, consistency, and convenience benefits to McDonald's, which does not have to deal with a number of local suppliers in each country. Economies of scope can also increase a company's market power as compared to competitors, because the company develops broad knowledge of the cultural, social, economic, and other factors that affect its customers in varied locations and can provide specialized products and services to meet those needs. Amway had to change everything about the company to survive and prosper in China, and the expanded scope has helped the company thrive in other areas as well.

IN PRACTICE

Amway

Amway started in 1959 with a direct sales model of independent entrepreneurs selling straight to consumers. By the late 1980s, more than half of Amway's revenues were coming from outside the United States, so when the company began selling in the People's Republic of China in 1995, it already had experience in that part of the world. Within a few years, China was a $200 million business and growing fast. Then, China pulled the plug, outlawing direct selling because of unethical actions of some non-Amway sellers.

Amway could be put out of business. Or, argued Eva Cheng, who ran Amway China at the time, it could cooperate with the Chinese government to find a solution. Over the next

(*continued*)

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several years, regulatory changes in China required that Amway ask hard questions and repeatedly revise its business model. In fact, the company changed its business model five times in order to do business in China. For one thing, the company established physical stores, selling products to people who came in off the street, something it had never done before. Rather than importing products from the United States, it began manufacturing them in China. Managers changed their entire distributor compensation system in China. They also began doing brand advertising since they could no longer rely on the word-of-mouth marketing that drove direct sales. Amway took the long-term view, and today, China is the company's largest market. Its annual sales there have exceeded $4 billion in recent years.

The changes Amway made in China were a huge leap in scope at the time, but it has since successfully used some of them in other markets. In addition, being forced to revise the business made managers realize the importance of regularly questioning the business model and adapting to succeed in different global markets.[20]

Low-Cost Production Factors. The third major force motivating global expansion relates to **factors of production**. One of the earliest, and still one of the most powerful, motivations for U.S. companies to invest abroad is the opportunity to obtain raw materials, labor, and other resources at the lowest possible cost. Organizations have long turned overseas to secure raw materials that were scarce or unavailable in their home country. In the early twentieth century, for example, tire companies went abroad to develop rubber plantations to supply tires for America's growing automobile industry. Today, U.S. paper manufacturers such as Weyerhaeuser and International Paper Co., forced by environmental concerns to look overseas for new timberlands, are managing millions of acres of tree farms in New Zealand and other areas.[21]

Many companies also turn to other countries as a source of low-cost labor. Apple's iPhones and iPads are made overseas by contract manufacturers such as Foxconn Technologies and Pegatron Corporation. Despite criticism of their labor practices, it is unlikely many of those jobs will come back to the United States. When Apple CEO Tim Cook decided to manufacture a Mac computer in the United States, the company found that the Austin, Texas, manufacturer couldn't get the number of screws it needed to keep production going. In China, on the other hand, factories produce vast quantities of custom screws on short notice. Cook and other Apple leaders say the scale, speed, and flexibility of the factories and the skills and diligence of the workers overseas are as important as the low labor costs.[22]

Textile manufacturing in the United States is now practically non-existent, as companies have lowered costs by shifting most production to Asia, Mexico, Latin America, and the Caribbean. Manufacturing of non-upholstered furniture has rapidly followed the same pattern, with companies closing plants in the United States and importing high-quality wooden furniture from China, where as many as 30 workers can be hired for the cost of one cabinetmaker in the United States.[23] But the trend isn't limited to manufacturing. A growing number of service firms in India write software, perform consulting work, and handle technical support, accounting, and data processing for some of the biggest corporations in the United States. One index lists more than 900 business services companies in India that employ around 575,000 people.[24]

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6.1b Managing the Stages of International Development

No company can become a global giant overnight; managers consciously adopt a strategy for global development and growth. Organizations enter foreign markets in a variety of ways and follow diverse paths. However, the shift from domestic to global typically occurs through stages of development, as illustrated in Exhibit 6.2.[25]

Domestic Stage. In stage one, the **domestic stage**, the company is domestically oriented, but managers are aware of the global environment and may want to consider initial foreign involvement to expand production volume and realize economies of scale. Market potential is limited and is primarily in the home country. The structure of the company is domestic, typically functional or divisional, and initial foreign sales are handled through an export department. The details of freight forwarding, customs problems, and foreign exchange are handled by outsiders.

International Stage. In stage two, the **international stage**, the company takes exports seriously and begins to think multidomestically. **Multidomestic** means competitive issues in each country are independent of other countries; the company deals with each country individually. The concern is with international competitive positioning compared with other firms in the industry. At this point, an international division has replaced the export department, and specialists are hired to handle sales, service, and warehousing abroad. Multiple countries are identified as potential markets. Purafil, with headquarters in Doraville, Georgia, manufactures air filters that remove pollution and cleanse the air in 60 different countries.[26] The company first began exporting in the early 1990s and now earns 60 percent of its revenues from overseas. A service example is AlertDriving, a firm that provides online training courses to companies with vehicle fleets. The company must tailor its products and marketing to the expectations, driving habits, and geographical distinctions in the 20 or so countries where it exports.[27]

Multinational Stage. In stage three, the **multinational stage**, the company has extensive experience in a number of international markets and has established marketing, manufacturing, or research and development (R&D) facilities in several foreign countries. The organization obtains a large percentage of revenues from sales outside the home country. Explosive growth occurs as international operations take off, and the company

	I. Domestic	II. International	III. Multinational	IV. Global
Strategic orientation	Domestically oriented	Export-oriented, multidomestic	Multinational	Global
Stage of development	Initial foreign involvement	Competitive positioning	Explosion	Global
Structure	Domestic structure plus export department	Domestic structure plus international division	Worldwide geographic product structure	Matrix, transnational structure
Market potential	Moderate, mostly domestic	Large, multidomestic	Very large, multinational	Whole world

EXHIBIT 6.2 Four Stages of International Evolution

Source: Based on Nancy J. Adler, *International Dimensions of Organizational Behavior*, 4th ed. (Cincinnati, OH: South-Western, 2002), 8–9; and Theodore T. Herbert, "Strategy and Multinational Organization Structure: An Interorganizational Relationships Perspective," *Academy of Management Review* 9 (1984), 259–271.

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has business units scattered around the world along with suppliers, manufacturers, and distributors. Companies in the multinational stage include Siemens of Germany, Sony of Japan, and Coca-Cola of the United States. Aditya Birla Group is an example of a multinational based in India. The company began in 1850 as the Birla family's trading company. Starting in the 1970s in Southeast Asia, the Birla Group has expanded around the world, operating in 35 countries and producing and selling such products as fiber, chemicals, cement, metals, yarns and textiles, apparel, fertilizer, and carbon black. In 2018, more than 50 percent of the company's revenues came from outside India.[28]

Global Stage. The fourth and ultimate stage is the **global stage**, which means the company transcends any single country. The business is not merely a collection of domestic industries; rather, subsidiaries are interlinked to the point where competitive position in one country significantly influences activities in other countries.[29] Truly **global companies** no longer think of themselves as having a single home country and, indeed, have been called *stateless corporations*.[30] This represents a new and dramatic evolution from the multinational company of the 1960s and 1970s. At this stage, ownership, control, and top management tend to be dispersed among several nationalities.[31] Nestlé SA provides a good example. The company gets most of its sales from outside the "home" country of Switzerland, and its 308,000 employees are spread all over the world. CEO Ulf Mark Schneider is German, Chairman Paul Bulcke is Belgian, and more than half of the company's managers are non-Swiss. Nestlé has hundreds of brands and has production facilities or other operations in almost every country in the world.[32]

Global companies operate in truly global fashion, and the entire world is their marketplace. Global companies such as Nestlé, Royal Dutch/Shell, Unilever, and Matsushita Electric may operate in more than a hundred countries. The structural problem of holding together this huge complex of subsidiaries scattered thousands of miles apart is immense. Organization structure for global companies can be extremely complex and often evolves into an international matrix or transnational model, which will be discussed later in this chapter.

The Need for Cultural Intelligence. As companies progress through the stages of international development, managers and employees encounter a growing need for cultural intelligence. **Cultural intelligence** refers to the ability to use reasoning and observation skills to interpret unfamiliar gestures and situations and devise appropriate behavioral responses.[33] Rather than a list of global "dos and don'ts," cultural intelligence enables a person to ferret out clues to a culture's shared understandings and respond to new situations in culturally appropriate ways. Recent problems at a glassmaking plant illustrate the need for cultural intelligence. The Chinese company Fuyao Glass Industry Group invested more than a half-billion dollars to revamp an abandoned General Motors plant near Dayton, Ohio, to be close to American-based auto manufacturers that buy millions of windshields each year. However, Chinese and American managers and employees have clashed over how to do things. Company chairman Cao Dewang says productivity "is not as high as we have in China" because some of the American employees "are just idling around." The Americans, on the other hand, say the Chinese supervisors are sacrificing safety to reach high production targets. Fuyao's American head of human resources, Eric Vanetti, recognizes the problem as a cultural one. "The Chinese have a bias toward speed; Americans like to process things, think it through from all angles."[34] How effective would you be managing in a global corporation and interacting with people from many different cultures? Complete the questionnaire in the "How Do You Fit the Design?" box to assess your level of cultural intelligence.

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HOW DO YOU FIT THE DESIGN?

WHAT IS YOUR CULTURAL INTELLIGENCE?

Instructions: To what extent does each of the following statements characterize your behavior? Please honestly answer each item below as Mostly True or Mostly False for you.

	Mostly True	Mostly False
1. I think about how I'm going to relate to people from a different culture before I meet them.	___	___
2. I understand the major religions and how they impact other cultures.	___	___
3. I know about the geography, history, and cultural leaders of several countries.	___	___
4. I regularly discuss world events with family and friends.	___	___
5. I seek out opportunities to interact with people from different cultures.	___	___
6. I can adapt to living in a different culture with relative ease.	___	___
7. I am confident that I can befriend locals in a culture that is unfamiliar to me.	___	___
8. I find work on a multicultural team very satisfying.	___	___
9. I regularly associate with people from cultural backgrounds different from me.	___	___
10. I alter my facial expressions and gestures as needed to facilitate a cross-culture interaction.	___	___
11. I am quick to change the way I behave when a cross-culture encounter seems to require it.	___	___
12. I take pleasure in talking with someone whose English is limited.	___	___

Scoring and Interpretation: The scores for these questions pertain to some aspect of *cultural intelligence,* which is a manager's capability to function well in situations characterized by cultural diversity. Give yourself 1 point for each Mostly True item as indicated below:

Cognitive CQ, items 1–4. Score = ____.
Emotional CQ, items 5–8. Score = ____.
Behavioral CQ, items 9–12. Score = ____.

Cognitive CQ pertains to the head, emotional CQ pertains to the heart, and behavioral CQ pertains to the body. If you have sufficient international experience and CQ to have scored 3–4 on all three parts, then consider yourself at a high level of CQ. If you scored 1–2 on all three parts, it is time to learn more about other national cultures. Hone your observational skills, take courses, look for international travel opportunities, and learn to pick up on clues about how people from a different country respond to various situations. Compare your scores to other students. If you are not fascinated by diverse people and cultures, how might you develop greater empathy for people who are different from you?

Source: Based on P. Christopher Earley and Elaine Mosakowski, "Cultural Intelligence," *Harvard Business Review*, October 2004, 139–146; Soon Ang, Lynn Van Dyne, Christine Koh, K. Yee Ng, Klaus J. Templer, Cheryl Tay, and N. Anand Chandrasekar, "Cultural Intelligence: Its Measurement and Effects on Cultural Judgment and Decision Making, Cultural Adaptation, and Task Performance," *Management and Organization Review* 3 (2007), 335–371; and David C. Thomas and Kerr Inkson, *Cultural Intelligence: People Skills for Global Business* (San Francisco: Berrett-Koehler, 2004).

Developing high cultural intelligence requires being open and receptive to new ideas and approaches. Living or working in a different country is one of the best ways people can stretch beyond their comfort zones and develop a broader, more global perspective. One study found that people who adapt to global management most easily are those who have grown up learning how to understand, empathize, and work with others who are different from themselves. Consider, for example,

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that people growing up in Singapore consistently hear English and Chinese spoken side by side. English Canadians must not only be well versed in American culture and politics, but they also have to consider the views and ideas of French Canadians who, in turn, must learn to think like North Americans, members of a global French community, Canadians, and Quebecois.[35] People who have grown up without this kind of language and cultural diversity typically have more difficulties adapting to working globally, but willing managers from any country can learn to open their minds and appreciate other cultural viewpoints.

6.1c Global Expansion Through International Alliances and Acquisitions

BRIEFCASE

As an organization manager, keep this guideline in mind:

Develop international strategic alliances, such as licensing and joint ventures, as fast and inexpensive ways to become involved in international sales and operations.

One of the most popular ways companies get involved in international operations is through international alliances. Considering the difficulties of understanding varied government regulations around the world, grasping the nuances of other cultures, and meeting the needs of people in different countries, many executives realize it makes sense to partner with organizations that already know and serve the area. Recall from Chapter 4 the impossible task Uber had going it alone in China rather than aligning with a local partner that could help the company navigate in the risky and complex environment. It eventually sold its business there to local rival Didi Chuxing. Didi's founder Cheng Wei, who has plans for his company to rule the ride-sharing market in the rest of the world just as it rules the Chinese market now, says Didi's global approach is different. "Our strategy isn't always to do everything ourselves," he says.[36] Companies in rapidly changing industries such as media and entertainment, pharmaceuticals, biotechnology, and digital information technology might have hundreds of international alliance relationships.[37]

Typical alliances include licensing, joint ventures, and acquisitions.[38] Recall our discussion of these techniques from the previous chapter as types of resource-dependence relationships. They are also used for expanding internationally. For example, when entering new markets, particularly in developing areas of the world, retailers such as Saks Fifth Avenue and Barneys New York limit their risks by licensing their names to foreign partners. Saks has licensed stores in Riyadh and Dubai, Saudi Arabia, and Mexico, for instance, and Barneys operates 12 stores in Japan under a license agreement.[39] The Hershey Company has numerous license agreements, such as with Maeil Dairies for chocolate milk in South Korea and with Lotte for ice cream in Japan. Ernest Savo, director of global licensing and business development, says the company has "always used licensing as a way into a marketplace and as a way to build brand impressions and affinity for Hershey's."[40]

As described in the previous chapter, a **joint venture** is a separate entity created with two or more active firms as sponsors. This is a popular approach to sharing development and production costs and penetrating new markets.[41] Joint ventures may be with either customers or competitors. The Hershey Company partnered with panettone maker Bauducco in a joint venture to make chocolates in Brazil. Competing automakers Renault, Nissan, and Mitsubishi formed an alliance several years ago, initially to build a low-cost car for emerging markets. Although the partnership has struggled, it remains intact and leaders have recently recommitted to a "win-win-win" operation, as Nissan CEO Hiroto Saikawa phrased it. With automakers working on the development of electric and autonomous vehicles, Renault's chairman Jean-Dominique Senard emphasized at an early 2019 news conference that the companies "must cooperate or die."[42] Competitors Sprint, Deutsche Telecom, and

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Telecom France cooperate with each other and with several smaller firms in a joint venture that serves the telecommunication needs of global corporations in 65 countries.[43] Navistar International Corporation, based in Warrenville, Illinois, formed a joint venture with rival Mahindra & Mahindra Ltd., a fast-growing equipment maker in India, to build trucks and buses for export.[44]

Companies often seek joint ventures and other alliances to achieve production cost savings through economies of scale, to share complementary technological strengths, to distribute new products and services through another country's distribution channels, or to take advantage of a partner's knowledge of local markets. However, when they can persuade senior managers of foreign companies to stay on, many companies prefer acquisitions because they offer greater control than joint ventures. Walmart recently made the largest acquisition in its history to expand its global e-commerce business, as described in the following In Practice.

ZUMA Press, Inc./Alamy Stock Photo

IN PRACTICE
Walmart and Flipkart

Walmart is fighting for its life against Amazon, both in the United States and abroad. That's one reason Walmart managers paid $16 billion for a majority share of India's largest, but still unprofitable e-commerce company, Flipkart Group.

Walmart's profits took a hit because of the acquisition, but executives thought it was worth absorbing losses in the short term to gain traction in a large and growing market where Amazon and other big e-commerce companies don't yet have a head start. "It's got scale, it's got growth, but it's also got a great management team," Judith McKenna, CEO of Walmart International, said of the acquisition. "It's a unique moment in time to enter that market." When Amazon entered India, backed by more than $5.5 billion in capital, Flipkart suffered. Amazon, as a larger firm with plenty of money, was able to steal customers from Flipkart by offering lower prices even if it hurt company profits.

The stakes are high, but so is the potential, as online shopping continues to grow among a young population four times the size of that in the United States. The e-commerce market in India is projected to reach $200 billion by 2026. Flipkart has the advantage of being a homegrown company. It has faced fewer legal and regulatory barriers than Amazon, and its managers better understand the local environment and customer expectations. Nevertheless, Amazon has been moving fast to learn what it takes to be first in the hearts and minds of India's growing ranks of online shoppers.[45]

Other companies also use acquisitions for international growth. For example, home-grown Chinese brands have struggled internationally, but Chinese companies have learned that they can succeed by buying strong brands overseas and keeping them healthy. Chinese companies have acquired a number of foreign firms, including Volvo, AMC movie theaters, Ferretti Italian luxury yachts, and Smithfield Foods, which has long supplied U.S. grocery stores with Smithfield hams, Eckrich sausages, Armour meatballs, and Farmland bacon. The $4.7 billion purchase of Smithfield by Shuanghui International Holdings Ltd. was the largest Chinese acquisition to date, but Chinese companies probably will not stop there. These acquisitions are reshaping the global business landscape.[46] In many cases, the Chinese companies

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keep local managers and let them run the companies. When China's property conglomerate Dalian Wanda Group Corporation bought AMC Entertainment Holdings Inc., for instance, it sent a financial team to the United States, but it let U.S. management decide how to use their strategic budget.[47]

REMEMBER THIS

- Almost every company today is affected by significant global forces, and many have developed overseas operations to take advantage of global markets. Three primary motivations for global expansion are to realize economies of scale, exploit economies of scope, and achieve scarce or low-cost factors of production such as labor, raw materials, or land.
- Organizations typically evolve through four stages, beginning with a domestic orientation, shifting to an international orientation, then changing to a multinational orientation, and finally moving to a global orientation that sees the whole world as a potential market. Organizations typically use an export department, then use an international department, and eventually develop into a worldwide geographic or product structure.
- As companies move to higher stages of international involvement, managers and employees face a greater need for cultural intelligence.
- One popular way to become involved in international operations is through strategic alliances with international firms. Alliances include licensing, joint ventures, and acquisitions.
- Living or working in a different country is one of the best ways people can stretch beyond their comfort zones and develop a broader, more global perspective.

6.2 The Challenges of Global Design

Managers taking their companies international face a tremendous challenge in how to capitalize on the incredible opportunities that global expansion presents. Exhibit 6.3 illustrates the three primary challenges global organizational design faces: greater complexity and differentiation, an increased need for integration, and more difficulty transferring knowledge and innovation. Organizations have to accept an extremely high level of environmental complexity in the international domain and address the many differences that occur among countries. Each country has its own history, culture, laws, and regulatory system. People eat different foods, observe different religions, have different attitudes, and subscribe to different social customs.[48] This environmental complexity and country variations require greater organizational differentiation, as described in Chapter 4.

At the same time, organizations must find ways to effectively achieve coordination and collaboration among far-flung units and facilitate the development and transfer of organizational knowledge and innovation for global learning.[49] Although many small companies are involved in international business, most international companies grow very large, creating a huge coordination problem. Exhibit 6.4 provides some understanding of the size and impact of international firms by comparing the revenues of several large multinational companies with the gross domestic product (GDP) of selected countries.

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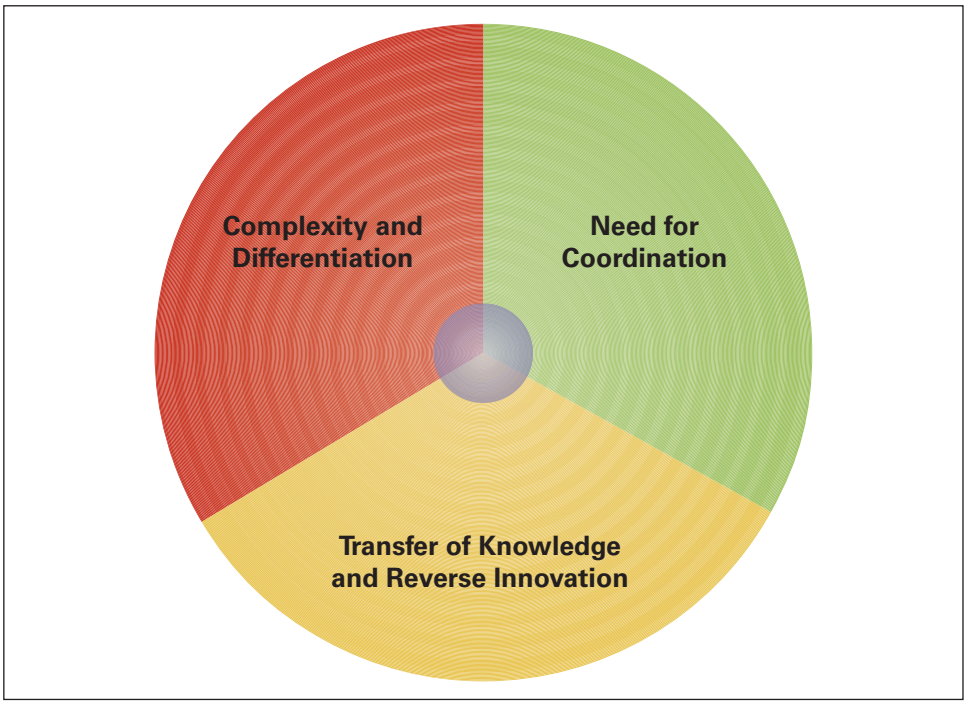

EXHIBIT 6.3
Challenges of Global Design

Company	Revenue*	Country	Annual GDP†
Walmart	485,873 million	Belgium	468,148 million
Volkswagen	276,264 million	Chile	250,008 million
Apple	229,234 million	Portugal	205,269 million
Amazon	117,900 million	Kuwait	110,873 million
Microsoft	89,950 million	Slovakia	89,806 million
Johnson & Johnson	76,450 million	Ethiopia	73,151 million
Telefónica	62,341 million	Luxembourg	58,655 million
Repsol	49,747 million	Lebanon	49,611 million
Facebook	39,300 million	Serbia	38,300 million
Coca-Cola	35,410 million	Bolivia	34,053 million

*This size comparison is assuming revenues were valued at the equivalent of GDP.
†Gross domestic product.

Source: Based on data reported in Fernando Belinchón and Ruqayyah Moynihan, "25 Giant Companies That Are Bigger Than Entire Countries," *Business Insider*, July 26, 2018, https://www.businessinsider.com/25-giant-companies-that-earn-more-than-entire-countries-2018-7 (accessed April 24, 2019).

EXHIBIT 6.4
Comparison of Leading Multinationals and Selected Countries, 2017 (in U.S. dollars)

6.2a Increased Complexity and Differentiation

When organizations enter the international arena, they encounter a greater level of internal and external complexity than anything experienced on the domestic front. Managers have to create a structure to operate in numerous countries that differ in economic development, language, political systems and government regulations, cultural norms and values, and infrastructure such as transportation and communication facilities. Consider the challenges Amazon is facing in India. As mentioned previously, Amazon, India's Flipkart (now owned by Walmart), and other local

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startups are all battling to capture the growing numbers of Indian customers shopping online. To serve customers in rural areas, Amazon has contracted with small local stores to set up space to walk people through the process of ordering online, added video descriptions of products for customers who can't read, modified its app to work with inexpensive smartphones and spotty cellular service, and altered procedures so people can pay with cash. The biggest challenge is delivery. More than 20,000 tiny, local stores signed up for the "I Have Space" program and now serve as links in Amazon's distribution network, accepting packages and delivering them in the neighborhood, often by bicycle down dirt roads with no addresses.[50]

All the complexity in the international environment is mirrored in a greater internal organizational complexity. Recall from Chapter 4 that as environments become more complex and uncertain, organizations grow more highly differentiated, with many specialized positions and departments to cope with specific sectors in the environment. In the Amazon example above, many new and specialized tasks had to be adopted for Amazon to adapt to India's culture. Top management might need to set up specialized departments to deal with the diverse government, legal, and accounting regulations in various countries. Most companies want to follow local laws and sentiments, but they also want to exercise discretion, so they often use teams of lawyers and other experts to monitor complaints and decide how to respond.[51]

In addition to departments to deal with diverse laws and regulations, companies operating internationally need more boundary-spanning departments to sense and respond to the external environment. Some companies disperse operations such as engineering, design, manufacturing, marketing, and sales around the world. In particular, many organizations have set up global product development systems to achieve greater access to international expertise and design products that are better suited to global markets. A Deloitte Research study found that 48 percent of North American and Western European manufacturers surveyed had set up engineering operations in other countries.[52] International organizations also might implement a variety of strategies, a broader array of activities, and a much larger number of products and services on an international level.

6.2b Increased Need for Coordination

As organizations become more differentiated, with multiple products, divisions, departments, and positions scattered across numerous countries, managers face a tremendous coordination challenge. *Coordination* refers to the quality of collaboration across organizational units. The question is how to achieve the integration and collaboration that is necessary for a global organization to reap the benefits of economies of scale, economies of scope, and labor and production cost efficiencies that international expansion offers. Recall from Chapter 4 that even in a domestic firm, high differentiation among departments requires that more time and resources be devoted to achieving coordination because employees' attitudes, goals, and work orientations differ widely. Imagine what it must be like for an international organization, whose operating units are divided not only by goals and work attitudes but by geographic distance, time differences, cultural values, and perhaps even language as well. Companies must find ways to share information, ideas, new products, and technologies across the organization. All organizations working globally face the challenge of getting all the pieces working together in the right way at the right time and in the right place.

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6.2c Transfer of Knowledge and Reverse Innovation

The third piece of the international challenge is for organizations to learn from their international experiences by sharing knowledge and innovations across the enterprise. The diversity of the international environment offers extraordinary opportunities for learning, development of diverse capabilities, and startling innovations in products and services. Essilor International SA, the world's largest manufacturer of ophthalmic corrective lenses, for example, engineers its lenses in Germany, makes blanks from high-transparency polymers in the United States, and adds microthin coatings in Japan.[53]

Some experts believe one way to cope with the challenge of knowledge and innovation transfer between countries is to have a greater percentage of radical innovations from companies in emerging markets such as China and India.[54] The old approach to innovation was for innovations in products and services to originate in and for developed countries and then be modified for use in less developed areas of the world. With a new approach called **reverse innovation**, companies create innovative, low-cost products or services for emerging markets then quickly and inexpensively adapt and repackage them for sale in developed countries. The trend toward reverse innovation, sometimes called *trickle-up innovation,* has organizations paying attention more than ever to the need for mechanisms that encourage sharing across the international enterprise. Consider products for the healthcare profession. GE Healthcare had a solid presence in China, but its high-end ultrasound machines and other products didn't meet the needs of healthcare practitioners working in poorly funded, low-tech hospitals or clinics in rural villages. Price, portability, and ease of use were the important criteria. GE Healthcare formed a semiautonomous "local growth team" in China that, drawing on local talent and combining product development, sourcing, manufacturing, and marketing in one business unit, created a portable ultrasound machine that sold for less than 15 percent of the cost of the company's high-end ultrasound machines. GE now sells the product around the world, and it grew to a $278 million global product line within six years.[55] GE's then-CEO Jeff Immelt said, "If we don't come up with innovations in poor countries and take them global, new competitors from the developing world—like Mindray, Suzlon, and Goldwind—will."[56] Exhibit 6.5 lists some additional examples of reverse innovation.

Organizational units in each location acquire the skills and knowledge to meet environmental challenges that arise in that particular locale. As the trend toward reverse innovation shows, much of that knowledge, which may be related to product improvements, operational efficiencies, technological advancements, or myriad other competencies, is relevant across multiple countries, so organizations need systems that promote the transfer of knowledge and innovation across the global enterprise. A classic example comes from Procter & Gamble (P&G). Liquid Tide was one of P&G's most successful U.S. product launches in the 1980s, but the product came about from the sharing of innovations developed in diverse parts of the firm. Liquid Tide incorporated a technology for helping to suspend dirt in wash water from P&G headquarters in the United States, the formula for its cleaning agents from P&G technicians in Japan, and special ingredients for fighting mineral salts present in hard water from company scientists in Brussels.[57]

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EXHIBIT 6.5
Examples of Reverse Innovation

Company	Innovation and Application
Groupe Danone	Built tiny plants in Bangladesh that produce one-hundredth of the yogurt a typical Danone factory produces and then discovered that they can operate almost as efficiently as the firm's large factories, spurring Danone to adapt the concept to other markets
Nestlé	Took the Maggi brand dried noodles created as a low-cost meal for rural Pakistan and India and repositioned it as a budget-friendly health food in Australia and New Zealand
General Electric	Created an inexpensive portable electrocardiogram machine for sale in India, where medical practitioners face power fluctuations, lack of funding and space for big machines, high levels of dust, and difficulty replacing parts in expensive equipment, and now sells it in the United States as well as other countries around the world
Hewlett-Packard	Has a team in India looking for ways to migrate web-interface applications created for mobile phones in Asia and Africa to developed markets in the United States and Europe
John Deere	John Deere India developed a high-quality low-cost tractor for farmers in India that is now increasingly in demand in the United States among farmers reeling from the recession and that will play a big role in Deere's expansion in Russia

Source: These examples are from Michael Fitzgerald, "As the World Turns," *Fast Company*, March 2009, 33–34; Reena Jana, "Inspirations from Emerging Economies," *BusinessWeek*, March 23 & 30, 2009, 38–41; Jeffrey R. Immelt, Vijay Govindarajan, and Chris Trimble, "How GE Is Disrupting Itself," *Harvard Business Review*, October 2009, 3–11; and Navi Radjou, "Polycentric Innovation: A New Mandate for Multinationals," *The Wall Street Journal Online*, November 9, 2009, http://online.wsj.com/article/SB125774328035737917.html (accessed November 13, 2009).

Getting employees to transfer ideas and knowledge across national boundaries can be exceedingly challenging. When Luxembourg-based steelmaker ArcelorMittal wanted its Burns Harbor, Indiana, mill to boost productivity and profitability by using hypermodern equipment and techniques similar to a mill in Gent, Belgium, employees weren't overjoyed. They had long been accustomed to using paper and pencil to calculate the right mix of iron ore, coking coal, and limestone for every batch of steel; they resisted attending classes to learn to follow a computer's instructions. In a process called "twinning," two mills of similar size, age, and product mix are benchmarked against each other, with the weaker company told to copy the practices of the stronger one. So, ArcelorMittal flew more than 100 U.S. engineers and managers to Gent, Belgium, and told them to "do as the Belgians do." Today, the Burns Harbor mill has record output, with productivity approaching the level of the Belgian mill. Workers say twinning has helped avoid catastrophe and that their jobs are different, but better.[58] Many organizations tap only a fraction of the potential that is available from the cross-border transfer of knowledge and innovation. People scattered at different locations around the world sometimes have trouble building trusting relationships. Other reasons include:[59]

- Language barriers, cultural dissimilarities, and geographic distances can prevent managers from spotting the knowledge and opportunities that exist across disparate country units.
- Sometimes managers don't appreciate the value of organizational integration and want to protect the interests of their own division rather than cooperate with other divisions.
- Divisions sometimes view knowledge and innovation as power and want to hold on to it as a way to gain an influential position within the global firm.

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- The "not-invented-here" syndrome makes some managers reluctant to tap into the know-how and expertise of other units.
- Much of an organization's knowledge is in the minds of employees and cannot easily be written down and shared with other units.

To meet global challenges, managers encourage both the development and the sharing of knowledge, implement systems for tapping into knowledge wherever it exists, and share innovations across global units.

REMEMBER THIS

- Succeeding on a global scale is not easy. Three primary challenges facing global organizational design are addressing environmental complexity through greater organizational complexity and differentiation, achieving integration and coordination among the highly differentiated units, and implementing mechanisms for the transfer of knowledge and innovations.
- Most international companies grow very large. The revenues of giant companies such as Walmart, Volkswagen, and Apple are greater than the GDPs of many of the world's countries.
- Reverse innovation, which refers to creating innovative, low-cost products or services for emerging markets then quickly and inexpensively repackaging them for sale in developed countries, is one way large global firms address the challenge of knowledge and innovation transfer.

6.3 Designing Structure to Fit Global Strategy

Managers working in international firms strive to find the right strategy and structure for their particular situations. As we discussed in Chapter 3, an organization's structure must fit its situation by providing sufficient information processing for coordination and control while focusing employees on specific functions, products, or geographic regions. Organization design for international firms follows a similar logic, with special interest in global versus local strategic opportunities.

6.3a Strategies for Global Versus Local Opportunities

When organizations venture into the international domain, managers attempt to formulate a coherent global strategy that will provide synergy among worldwide operations for the purpose of achieving common organizational goals. One dilemma they face is choosing whether to emphasize global **standardization** versus local responsiveness. Managers must decide whether they want each global affiliate to act autonomously or whether activities should be standardized across countries. These decisions are reflected in the choice between a *globalization* versus a *multidomestic (localization)* global strategy.

The **globalization strategy** means that product design, manufacturing, and marketing strategy are standardized throughout the world, which is less costly than creating different products for different markets.[60] For example, Black & Decker became much more competitive internationally when it standardized its line of power hand tools. In general, services are less suitable for globalization because

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different customs and habits often require a different approach to providing service. Meliá Hotels International, the largest hotel chain in Spain and one of the top 20 hotel companies worldwide, for example, partners with local companies in joint ventures and other partnerships to acquire the know-how to operate in 43 different countries, including China, Bulgaria, the United States, Indonesia, Greece, Croatia, Brazil, Egypt, and the United Kingdom.[61]

Other companies have also begun shifting away from a strict globalization strategy. Economic and social changes, including a backlash against huge global corporations, have prompted consumers to be less interested in global brands and more in favor of products that have a local feel.[62] However, a globalization strategy can save a company money because it helps reap economy-of-scale efficiencies by standardizing product design and manufacturing, using common suppliers, introducing products around the world faster, coordinating prices, and eliminating overlapping facilities.[63] Gillette Company, which makes grooming products such as the Mach3 shaving system for men and the Venus razor for women, has large production facilities that use common suppliers and processes to manufacture products whose technical specifications are standardized around the world.[64]

ASSESS YOUR ANSWER

1 The only way an organization can reasonably expect to be successful in different countries is to customize its products and services to suit the local interests, preferences, and values in each country.

ANSWER: *Disagree.* It is the case that people around the world often want products and services that are tailored to their local needs and interests, and many organizations are quite successful by responding to local market demands. However, other international organizations attain competitive advantages by using the same product design and marketing strategies in many countries throughout the world.

A **multidomestic (localization) strategy** means that competition in each country is handled independently of competition in other countries. Thus, a multidomestic strategy would encourage product design, assembly, and marketing tailored to the specific needs of each country. Some companies have found that their products do not thrive in a single global market. For instance, people in different countries have very different expectations for personal-care products such as deodorant or toothpaste. Even American fast food chains, once considered ultimate examples of standardization for a world market, have felt the need to be more responsive to local and national differences. When KFC (Yum Brands) entered Asia in 1973, it tried to use a globalization strategy, but the 11 restaurants it opened closed within two years. Managers tried again with a multidomestic strategy and achieved remarkable success, particularly in China, where the chain gained a 40 percent market share, compared to 16 percent for McDonald's.[65] Also consider the approach Amazon is taking with its video streaming service in global markets. Roy Price, the head of Amazon Studios, said, "You can have a global service, but there are no global customers. There are only local customers." Unlike Netflix, which uses a globalization strategy, streaming movies and shows with broad global appeal, Amazon tailors its offerings to serve each country. It spent two years building a local video team in India before the service launched there, for example, and initiated agreements for showing Indian movies, sports, and other content.[66]

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Different global organization designs are better suited to the need for either global standardization or local responsiveness. Research on more than 100 international firms based in Spain provided support for the connection between international structure and strategic focus.[67] The model in Exhibit 6.6 illustrates how organization design and international strategy fit the needs of the environment.[68]

Companies can be characterized by whether their product and service lines have potential for globalization, which means advantages through worldwide standardization. Companies that sell similar products or services across many countries have a globalization strategy. On the other hand, some companies have products and services appropriate for a multidomestic (localization) strategy, which means local-country advantages through differentiation and customization to meet local needs.

In many instances, companies need to respond to both global and local opportunities simultaneously. *Glocalization* refers to the idea that in a global market, a product or service is more likely to succeed when it is customized for the locality or culture in which it is sold. A **glocalization strategy** seeks to achieve both global integration and local responsiveness.[69] A true glocalization strategy is difficult to achieve, however, because one goal requires close global coordination while the other requires local flexibility. However, many industries are finding that, although increased competition means that they must achieve global efficiency, growing pressure to meet local needs demands national responsiveness.[70] McDonald's is succeeding with a glocalization strategy. The giant international chain is global in its use of worldwide standards and training operations, but it is also local. McDonald's franchises to local entrepreneurs, sources many foods locally, and focuses on specific local preferences for restaurant design and menu choices. Customers in Indonesia can order bowls of buryam rice porridge with chicken and fried crisps, for example,

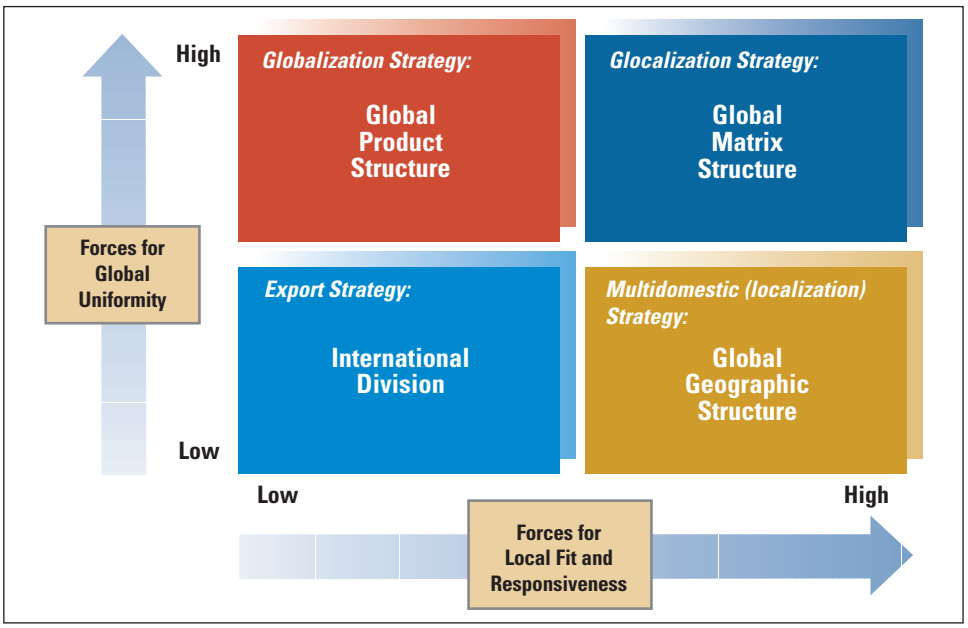

EXHIBIT 6.6
Model to Fit Organization Structure to International Advantages

Source: Based on Christopher A. Bartlett and Sumantra Ghoshal, *Text, Cases, and Readings in Cross-Border Management*, 3rd ed. (New York: Irwin McGraw-Hill, 2000), 395; Roderick E. White and Thomas A. Poynter, "Organizing for Worldwide Advantage," *Business Quarterly*, Summer 1989, 84–89; Gunnar Hedlund, "The Hypermodern MNC—A Heterarchy?" *Human Resource Management* 25, no. 1 (Spring 1986), 9–36; and J. M. Stopford and L. T. Wells, Jr., *Managing the Multinational Enterprise* (New York: Basic Books, 1972).

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and McDonald's restaurants in Hong Kong offer the kao fan burger, a fried chicken patty served in a bun made of rice.[71] Another company that effectively achieves both aspects of a glocalization strategy is Coca-Cola. The giant soft drink company can attain efficiencies by manufacturing, advertising, and distributing well-known brands such as Coke, Fanta, and Sprite on a global basis, but it sells more than 400 different drinks globally. For instance, Coca-Cola's version of the traditional kvass is the company's fastest-growing soft drink in Russia.[72]

As indicated in Exhibit 6.6, when forces for both global standardization and local responsiveness in many countries are low, simply using an international division with the domestic structure is an appropriate way to handle international business. For some industries, however, technological, social, or economic forces may create a situation in which selling standardized products worldwide provides a basis for competitive advantage because it enables the company to keep costs lower than if it had to provide products tailored to each market. In these cases, a global product structure is appropriate. This structure provides product managers with authority to handle their product lines on a global basis and enables the company to take advantage of a unified global marketplace. In other cases, companies can gain competitive advantages through local responsiveness—by responding to unique needs in the various countries in which they do business. For these companies, a worldwide geographic structure is appropriate. Each country or region will have subsidiaries that modify products and services to fit that locale. A good illustration is the advertising firm of Ogilvy & Mather Worldwide, which divides its operations into four primary geographic regions because advertising approaches need to be modified to fit the tastes, preferences, cultural values, and government regulations in different parts of the world.[73] Children are frequently used to advertise products in the United States, but this approach in France is against the law. The competitive claims of rival products regularly seen on U.S. television would violate government regulations in Germany.[74]

In many instances, companies need to respond to both global and local opportunities simultaneously, in which case the global matrix structure can be used. Part of the product line may need to be standardized globally and other parts tailored to the needs of local countries. In reality, there has been an escalating tension for most companies between the need for global uniformity and the need for local fit and responsiveness. Consider how General Electric, described in the Chapter 1 opening example, has been changing to address this growing tension.

IN PRACTICE

General Electric

Before he left the top job at General Electric (GE), former CEO Jeff Immelt wrote an article for *Fortune* magazine discussing how globalization had changed from being based on global integration to having "local capability within a global footprint." Immelt added, "Good global leaders have an appreciation for how people do their work in a local culture. They. . . make a team's work meaningful to their country."

Over the past couple of decades, GE has been trading its global approach designed for maximum efficiency for one that gives the company a bigger, more personal local presence, even when it hurts efficiency. The company's new locomotive factory in India, the centerpiece of a $200 million investment, provides an example. "Even many Indian companies would think five times" about building in Marhaura, a remote impoverished village 600 miles southeast of Delhi, said Banmali Agrawala, GE's India CEO. Project manager Shankar Dhar said, "If something takes three months, you give it six months here." GE has had to put down deeper local roots to win big business contracts. The Marhaura factory will build locomotives for Indian Railways' vast train network, one of the largest deals ever for GE's transportation division.

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GE has more than 400 factories spread around the world. It has also established engineering and research centers in countries such as Poland, Mexico, and Qatar and recently opened a business process outsourcing center in Saudi Arabia, employing 3,000 local women and led by a woman. The goal has shifted from moving into foreign countries to pursue lower labor or resource costs, to a strategy of building local connections as a way to serve new markets. As economic power has grown in countries such as India, China, and Indonesia, these areas want companies to "invest and build locally, teach local workers new skills, and share technological know-how," not just come in looking for lower costs.[75]

Other companies have also been pursuing stronger local connections. Honeywell International says it set up manufacturing in Asia to better grasp the "nuances" of emerging markets and introduced a line of hard hats designed to better fit the heads of Asian employees.[76] Most companies that operate globally use various mechanisms to address the tension between the need for global integration and the need for local responsiveness. Now let's discuss each of the structures in Exhibit 6.6 in more detail.

6.3b International Division

As companies begin to explore international opportunities, they typically start with an export department that grows into an **international division**. The international division has a status equal to the other major departments or divisions within the company and is illustrated in Exhibit 6.7. Whereas the domestic divisions are typically organized along functional or product lines, the international division is organized according to geographic interests, as illustrated in Exhibit 6.7. The international division has its own hierarchy to handle business (licensing, joint ventures) in various countries, selling the products and services created by the domestic divisions, opening subsidiary plants, and in general moving the organization into more sophisticated international operations.

Although functional structures are often used domestically, they are less frequently used to manage a worldwide business.[77] Lines of functional hierarchy running around the world would extend too long, so some form of product or geographic structure is used to subdivide the organization into smaller units. Firms typically start with an international department and, depending on their strategy, later use product or geographic division structures or a matrix. One study found that 48 percent of organizations identified as global leaders use divisional structures, while 28 percent reported using matrix structures.[78]

6.3c Global Product Division Structure

In a **global product structure**, the product divisions take responsibility for global operations in their specific product area. This is one of the most commonly used structures through which managers attempt to achieve global goals because it provides a fairly straightforward way to effectively manage a variety of businesses and products around the world. Managers in each product division can focus on organizing for international operations as they see fit and directing employees' energy toward their own division's unique set of global problems or opportunities.[79] In addition, the structure provides top managers at headquarters with a broad perspective on competition, enabling the entire corporation to respond more rapidly to a changing global environment.[80]

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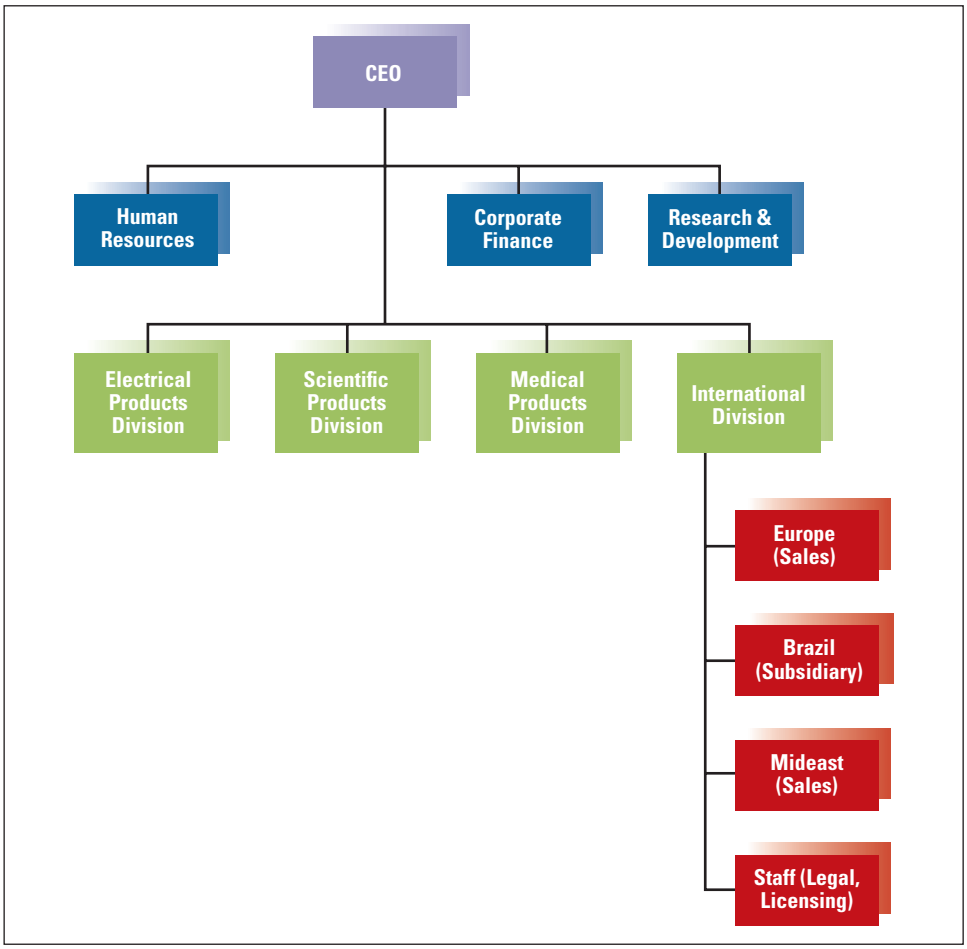
EXHIBIT 6.7
Domestic Mixed Structure with International Division



With a global product structure, each division's manager is responsible for planning, organizing, and controlling all functions for the production and distribution of its products or services for any market around the world. As we saw in Exhibit 6.6, the global product structure works best when the company has opportunities for worldwide production and sale of standard products for all markets, thus providing economies of scale and standardization of production, marketing, and advertising.

Eaton Corporation has used a form of worldwide product structure, as illustrated in Exhibit 6.8. In this structure, the automotive components group, industrial group, and so on are responsible for the manufacture and sale of products worldwide. The vice president of the international division is responsible for coordinators in each region, including a coordinator for Japan, Australia, South America, and northern Europe. The coordinators find ways to share facilities and improve production and delivery across all product lines sold in their regions. These coordinators fulfill the same function as integrators described in Chapter 3.

The product structure is great for standardizing production and sales around the globe, but it also has problems. Often the product divisions do not work well together, competing instead of cooperating in some countries; and some countries may be ignored by product managers. The solution adopted by Eaton Corporation of using country coordinators who have a clearly defined role is a superb way to

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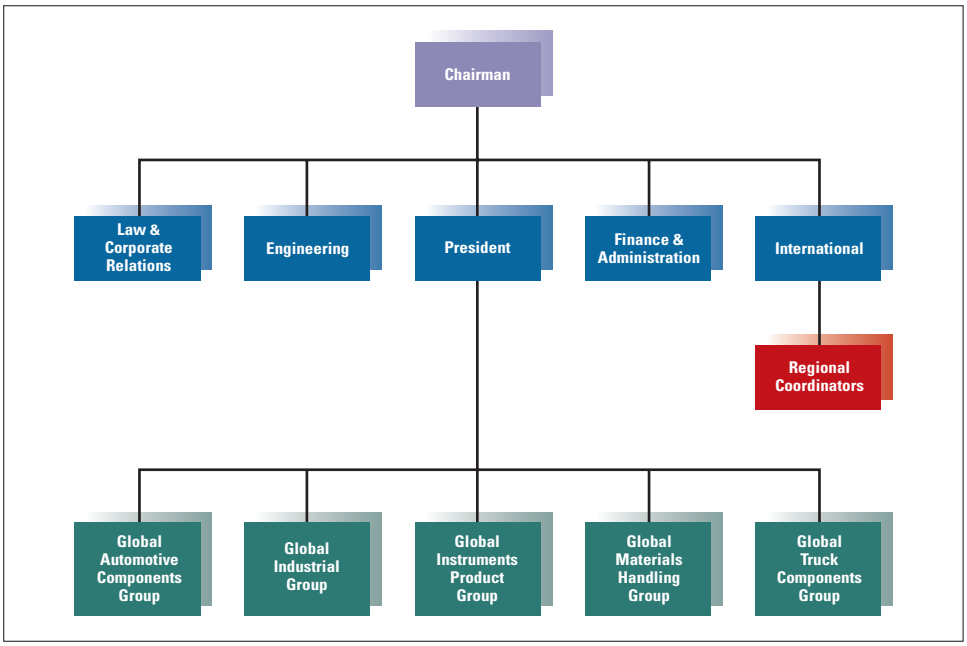

EXHIBIT 6.8
Partial Global Product Structure Used by Eaton Corporation

Source: Based on *New Directions in Multinational Corporate Organization* (New York: Business International Corp., 1981).

overcome these problems. Haier uses a radical type of product structure that breaks the company into 2,000 semiautonomous teams of 10 to 30 employees, each with its own P&L, and each focused on coordinating a specific product or project across several countries.[81]

6.3d Global Geographic Division Structure

A regionally based organization is well suited to companies that want to emphasize adaptation to regional or local market needs through a multidomestic strategy, as illustrated earlier in Exhibit 6.6. The **global geographic structure** divides the world into geographic regions, with each geographic division reporting to the CEO. Each division has full control of functional activities within its geographic area. For example, the largest branded food company in the world, Nestlé, with headquarters in Switzerland, puts great emphasis on the autonomy of regional managers who know the local culture. Nestlé rejects the idea of a single global market and has used a partial geographic structure to focus on the local needs and competition in each country. Local managers have the authority to tinker with a product's flavoring, packaging, portion size, or other elements as they see fit. Many of the company's 8,000 brands are registered in only one country.[82]

Companies that use this type of structure have typically been those with mature product lines and stable technologies. They can find low-cost manufacturing within countries as well as meet different needs across countries for marketing and sales. However, several business and organizational trends have led to a broadening of the kinds of companies that use the global geographic structure.[83] The growth of service organizations has outpaced manufacturing for several years, and services by their nature must occur on a local level. Italian bank UniCredit, with headquarters in Milan and 8,500 branches in 17 countries, has three main divisions: Commercial

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Choose a global product structure when the organization can gain competitive advantages through a globalization strategy (global uniformity). Choose a global geographic structure when the company has advantages with a multidomestic strategy (local fit and responsiveness). Use an international division when the company is primarily domestic and has only a few international operations.

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Banking Western Europe, Commercial Banking Central Eastern Europe, and a Corporate and Investment Banking division to serve multinational corporate clients.[84] Starbucks Coffee Company uses a three-region organization structure: China and Asia Pacific, which consists of the Japan, Korea, Hong Kong, Thailand, Malaysia, Singapore, Indonesia, Philippines, Australia, and New Zealand markets; the Americas, which includes the United States, Canada, Mexico, and Latin America; and EMEA, which encompasses Europe, the United Kingdom, Russia, the Middle East, and Africa.[85]

In addition, to meet new competitive threats, many manufacturing firms are emphasizing the ability to customize their products to meet specific needs, which requires a greater emphasis on local and regional responsiveness. All organizations are compelled by current environmental and competitive challenges to develop closer relationships with customers, which may lead companies to shift from product-based to geographic-based structures. India's Bupharm, a young and growing pharmaceuticals company, created geographic divisions for its sales operation, such as Asia Pacific, Latin America, and Europe, to help the company better serve customers in the 40 countries where it does business.[86]

The problems encountered by senior management using a global geographic structure result from the autonomy of each regional division. For example, it is difficult to do planning on a global scale—such as new-product R&D—because each division acts to meet only the needs of its region. New domestic technologies and products can be difficult to transfer to international markets because each division thinks it will develop what it needs. Likewise, it is difficult to rapidly introduce products developed offshore into domestic markets, and there is often duplication of line and staff managers across regions. Because regional divisions act to meet specific needs in their own areas, tracking and maintaining control of costs can be a real problem. The following example illustrates how executives at Colgate-Palmolive overcame some of the problems associated with the geographic structure.

IN PRACTICE

Colgate-Palmolive Company

For several years, Colgate-Palmolive Company, which manufactures and markets personal-care, household, and specialty products, used a global geographic structure of the form illustrated in Exhibit 6.9. Colgate has a long, rich history of international involvement and has relied on regional divisions in North America, Europe, Latin America, the Far East, and the South Pacific to stay on the competitive edge. Well over half of the company's total sales are generated outside of the United States.

The regional approach supports Colgate's cultural values, which emphasize individual autonomy, an entrepreneurial spirit, and the ability to act locally. Each regional president reports directly to the chief operating officer, and each division has its own staff functions such as human resources (HR), finance, manufacturing, and marketing. Colgate handled the problem of coordination across geographic divisions by creating an *international business development group* that is responsible for long-term company planning and worldwide product coordination and communication. It used several product team leaders, many of whom had been former country managers with extensive experience and knowledge. The product leaders are essentially coordinators and advisors to the geographic divisions; they have no power to direct, but they have the ability and the organizational support needed to exert substantial influence. The addition of this business development group quickly reaped positive results in terms of more rapid introduction of new products across all countries and better, lower-cost marketing.

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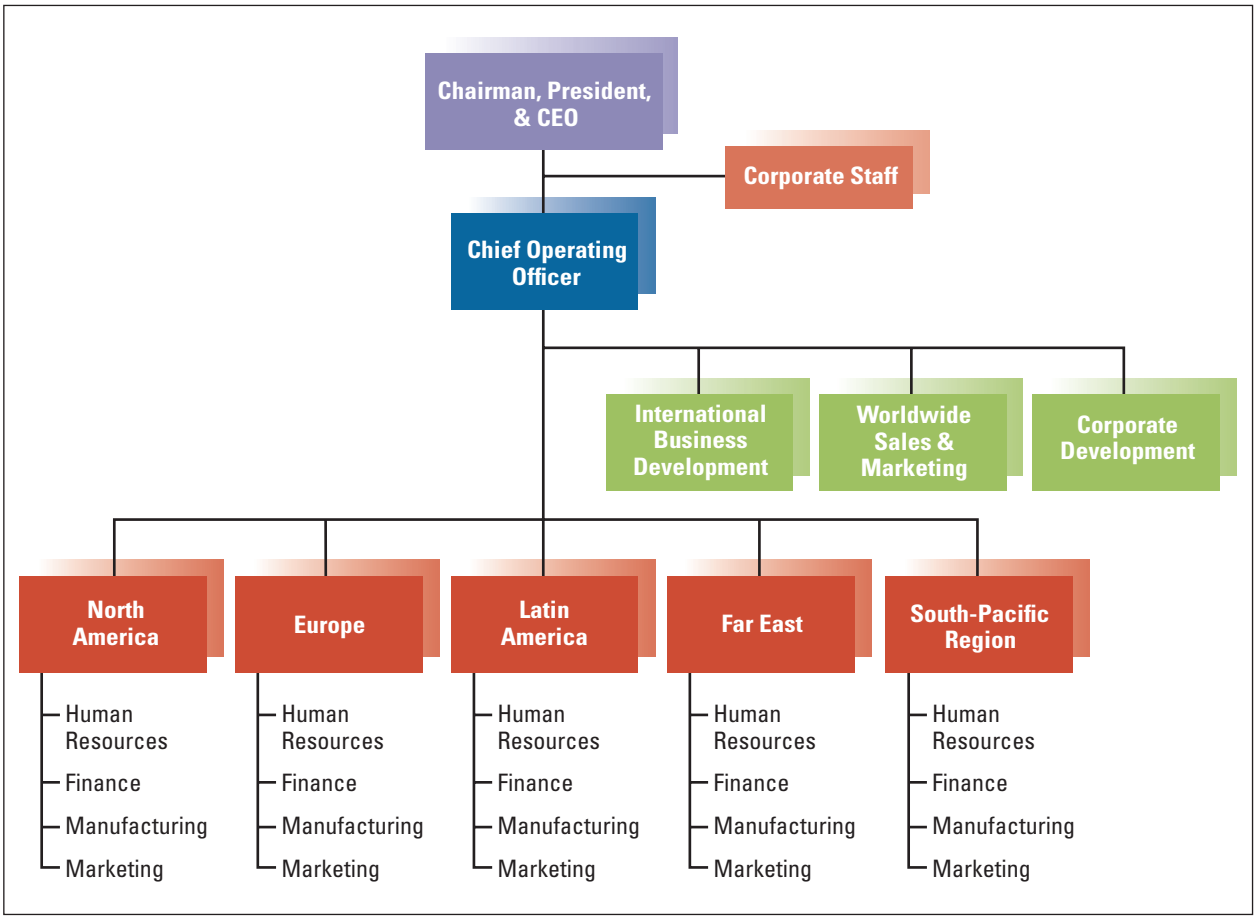
The success of the international business development group prompted Colgate's top management to add two additional coordinating positions—a *vice president of corporate development* to focus on acquisitions and a *worldwide sales and marketing group* that coordinates sales and marketing initiatives across all geographic locations. With these worldwide positions added to the structure, Colgate maintains its focus on each region and achieves global coordination for overall planning, faster product introductions, and enhanced sales and marketing efficiency.[87]

6.3e Global Matrix Structure

We've discussed how Eaton used a global product division structure and found ways to coordinate across worldwide divisions. Colgate-Palmolive used a global geographic division structure and found ways to coordinate across geographic regions. Each of these companies emphasized a single dimension. Recall from Chapter 3 that a matrix structure provides a way to achieve vertical and horizontal coordination simultaneously along two dimensions. A **global matrix structure** is similar to the matrix described in Chapter 3, except that for multinational corporations the geographic distances for communication are greater and coordination is more complex.

EXHIBIT 6.9
Global Geographic Structure of Colgate-Palmolive Company



Source: Based on Robert J. Kramer, *Organizing for Global Competitiveness: The Geographic Design* (New York: The Conference Board, 1993), 30.

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The matrix works best when pressure for decision making balances the interests of both product standardization and geographic localization and when coordination to share resources is important. The matrix can support a glocalization strategy, as illustrated in Exhibit 6.6; that is, it can enable a global firm to achieve aspects of both global uniformity and local diversification and responsiveness.[88] For many years, ABB (Asea Brown Boveri), a global leader in power and automation technologies, with headquarters in Zurich, used a global matrix structure that worked extremely well to coordinate a 150,000-employee company operating in approximately 100 countries.

IN PRACTICE

ABB Group

ABB has given new meaning to the notion of "being local worldwide." ABB has used a complex global matrix structure similar to Exhibit 6.10 to achieve worldwide economies of scale combined with local flexibility and responsiveness.

At the top are the chief executive officer and an executive committee of 10 top managers, who hold frequent meetings around the world. Along one side of the matrix are product division managers for Power Products, Power Systems, Discrete Automation and Motion, Low Voltage Products, and Process Automation. Each division manager is responsible for handling business on a global scale, allocating export markets, establishing cost and quality standards, and creating mixed-nationality teams to solve problems. Each division is subdivided into smaller units over which the division manager also has responsibility.

Along the other side of the matrix is a regional structure; ABB has eight regional managers for Northern Europe; Central Europe; Mediterranean; North America; South America; India, Middle East, and Africa; North Asia; and South Asia. Under the regional managers are country managers who run local companies that cross business areas and are responsible for local balance sheets, income statements, and career ladders.

The matrix structure converges at the level of the local companies. The presidents of local companies report to two bosses—the product division leader, who coordinates on a global scale, and the regional president, who runs the company of which the local organization is a subsidiary.

ABB's philosophy is to decentralize things to the lowest levels. Global managers are generous, patient, and multilingual. They must work with teams made up of different nationalities and be culturally sensitive. They craft strategy and evaluate performance for people and subsidiaries around the world. Regional managers, by contrast, are line managers responsible for several country subsidiaries. They must cooperate with product division managers to achieve worldwide efficiencies and the introduction of new products. Finally, the presidents of local companies have both a global boss—the product division manager—and a regional boss, and they learn to coordinate the needs of both.[89]

ABB is a large, successful company that achieved the benefits of both product and geographic organizations through this matrix structure. However, over the past several years, as ABB has faced increasingly complex competitive issues, leaders have transformed the company toward a complex structure called the *transnational model*, which will be discussed later in this chapter.

In the real world, many international firms such as ABB, Colgate, UniCredit, Nestlé, or Eaton Corporation combine two or more different structures or elements of different structures. Mixed structures are typical in highly volatile environments. UniCredit, for example, combines elements of functional, geographic, and product divisions to respond to dynamic market conditions in the multiple countries where it operates. General Mills, a large food company with brands including Cheerios, Annie's Yoplait, Häagen Dazs, Nature Valley, and Wanchai Ferry, recently added geographic divisions for North America, Europe and Australia, and Asia and Latin America to its

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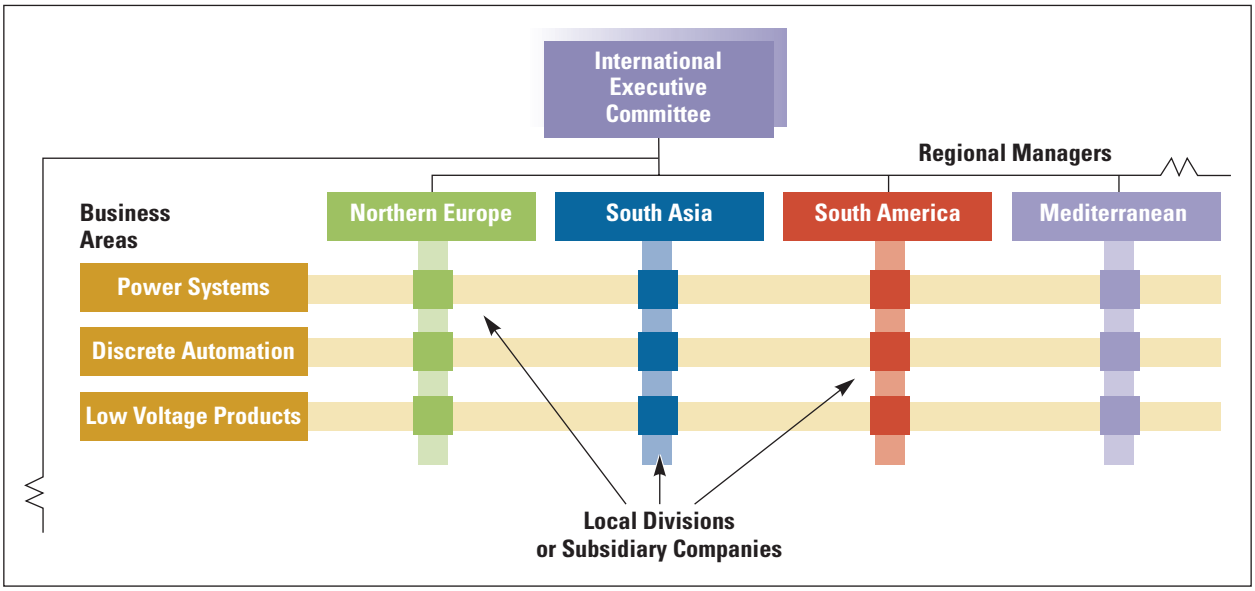
EXHIBIT 6.10
Global Matrix Structure



mix of functional and product divisions to "take the next step in our journey to truly operate as a global company," said Chairman and CEO Ken Powell.[90]

There is no *ideal* structure, and organizations that operate on a global scale frequently must make adjustments to their structures to overcome the challenges of doing business in a global environment. In the following sections, we will look at some additional coordination mechanisms used to address the challenges of operating on a global scale.

REMEMBER THIS

- Organizations try to match their design to fit their strategic goals.
- A global product division structure supports a globalization strategy, which means that products and services can be standardized and sold worldwide. Few companies can succeed with a strict globalization strategy today.
- Geographic structures are most effective for organizations that can benefit from a multidomestic (localization) strategy, meaning that products and services will do best if tailored to local needs and cultures.
- KFC (Yum Brands) gained a 40 percent market share in China after managers shifted from a globalization to a multidomestic (localization) strategy.
- Most companies are shifting away from strict globalization strategies. Glocalization refers to the concept that in a global market, a product or service is more likely to succeed when it is customized for the locality or culture in which it is sold.
- Huge global firms might use a matrix structure to respond to both local and global forces simultaneously.
- Many firms combine elements of two or more different structures to meet the dynamic conditions of the global environment.

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6.4 Additional Global Coordination Mechanisms

There are many instances of well-known companies that have trouble transferring successful ideas, products, and services from their home country to the international domain. As we discussed earlier in the chapter, greater complexity and differentiation, an increased need for coordination, and more difficult transfer of knowledge and innovation present challenges for global organization design. In addition, managers have to address the tension between the desire to achieve worldwide efficiency and uniformity and the desire to achieve local fit and responsiveness in each market they serve. Managers meet these global challenges in a variety of ways. Some of the most common are the use of global teams, stronger headquarters planning and control, and specific coordination roles.

6.4a Global Teams

One of the most valuable mechanisms for global coordination and the transfer of knowledge and innovation has been the use of global teams. In addition to these uses of teams, today's organizations are using teams specifically to address the tension between global uniformity and local responsiveness.[91] For example, as part of its efforts to balance local needs with worldwide scale, GE, described in a previous In Practice, created a team called the Global Growth Organization (GGO). Former CEO Jeff Immelt appointed a well-respected senior executive, John Rice, to lead the GGO. Rice recruited leaders from throughout the global businesses and functions who had strong networks and could enhance collaboration among GE's businesses in different global markets. As Rice put it, "We continually ask ourselves if we have the right resources in the right places, at the right time and focused on the right things." Since the launch of the GGO, GE's revenues outside the United States have grown from 54 percent of the company's worldwide total to 61 percent.[92]

Many companies, including GE, also use smaller global teams to enhance coordination. **Global teams**, also called *transnational teams,* are cross-border work groups made up of multiskilled, multinational members whose activities span multiple countries.[93] Typically, teams are of two types: intercultural teams, whose members come from different countries and meet face to face, and virtual global teams, whose members remain in separate locations around the world and conduct their work electronically.[94] Heineken formed the European Production Task Force, a 13-member team made up of multinational members, to meet regularly and come up with ideas for optimizing the company's production facilities across Europe.[95] German steelmaker ThyssenKrupp uses global virtual teams, applying sophisticated computer networks and software to link and coordinate team members working across three continents to run a virtually integrated steel operation.[96]

However, building effective global teams is not easy. Cultural and language differences can create misunderstandings, and resentments and mistrust can quickly derail the team's efforts. Consider what happened in one virtual team made up of members from India, Israel, Canada, the United States, Singapore, Spain, Brussels, Great Britain, and Australia:

> *Early on . . . team members were reluctant to seek advice from teammates who were still strangers, fearing that a request for help might be interpreted as a sign of incompetence. Moreover, when teammates did ask for help, assistance was not always forthcoming. One team member confessed to carefully calculating*

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how much information she was willing to share. Going the extra mile on behalf of a virtual teammate, in her view, came at a high price of time and energy, with no guarantee of reciprocation.[97]

As this quote shows, it is easy for an "us against them" mentality to develop, which is just the opposite of what organizations want from global teams.[98] No wonder when the executive council of *CIO* magazine asked global chief information officers to rank their greatest challenges, managing virtual global teams ranked as the most pressing issue.[99] L'Oréal, the French global cosmetics giant, is one of the most effective companies at building teams that improve coordination, transfer knowledge and innovation, help resolve the tension between uniformity and local responsiveness, and thwart the "us against them" mentality.

iStock.com/Arseniy Rogov

IN PRACTICE
L'Oréal

The global–local tension is often greatest when product development requires subtle, complex knowledge that can't be easily codified and written down. This so-called tacit knowledge resides in people's minds and is usually revealed only in action and interaction, which means it is subject to misinterpretation when it crosses borders. The cosmetics firm L'Oréal exemplifies this tension as well as any other company, because personal-care needs are unique to each culture. Yet the company has managed to be both very global and very local. It employs nearly 86,000 people in 150 locations around the world. In 2018, more than 43 percent of the company's sales came from new markets outside the United States and Europe, mostly in developing countries.

The upper management team has always been strongly rooted in L'Oréal's home culture, so how does the company bridge its products to other cultures? Product development is the firm's competitive advantage, so L'Oréal recruits and builds product development teams that report to managers who have mixed cultural backgrounds. A team of three or four people will usually have at least two who are multicultural, such as a Lebanese-Spanish-American manager working with a French-Irish-Cambodian or an Indian-American-French project manager. Product development teams share their ideas with each other and with top management as work progresses over the period of about a year. "Their background is a kind of master class in holding more than one idea at a time," said one director. "They think as if they were French, American, or Chinese, and all of these together at once."

How does that flexible perspective lead to knowledge transfer and innovation? A French-Irish-Cambodian manager working on skincare noticed that many tinted face creams in Asia had a lifting effect. At the time, most face creams in Europe were either tinted, and considered makeup, or lifting, and considered skin-care. The manager drew on his knowledge of Asian beauty trends and suggested a tinted cream for the French market that was a huge success.

As L'Oréal grows around the world, some of these multicultural managers are finding their way into senior management in the company, a sign that the approach is working. L'Oréal is beginning to place multicultural managers at the center of interactions among brands, regions, and functions and is increasingly encouraging the flow of knowledge from subsidiaries back to the home country as well as the old way from the home country to far-flung subsidiaries.[100]

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ASSESS YOUR ANSWER

2 It is an especially difficult challenge to work on a global team to coordinate one's own activities and share new ideas and insights with colleagues in different divisions around the world.

ANSWER: *Agree.* The problems of different languages, locations, cultural values, and business practices make membership of an international team especially difficult. Global teams can be effective only if members have the patience and skills to surmount the barriers and openly share information and ideas. Global teams perform better when they are made up of people who are culturally astute and genuinely want to coordinate and communicate with their counterparts in other countries.

6.4b Headquarters Planning

A second approach to achieving stronger global coordination is for headquarters to take an active role in planning, scheduling, and control to keep the widely distributed pieces of the global organization working together and moving in the same direction. In one survey, 70 percent of global companies reported that the most important function of corporate headquarters was to "provide enterprise leadership."[101] For example, Panasonic established a Global Consumer Marketing group to further the company's goal of being both global and local. The group is directed from the headquarters, with top leaders making decisions about resource allocation to further the goals of embracing the global–local tension. If top leaders don't make decisions that both further the cultivation of a global mindset and promote greater understanding of local markets in various countries, instead acting as mere observers, the goals aren't likely to be met.[102]

Without strong leadership, highly autonomous divisions can begin to act like independent companies rather than coordinated parts of a global whole. To counteract this, top management may delegate responsibility and decision-making authority in some areas, such as adapting products or services to meet local needs, while maintaining strong control through centralized systems in other areas to provide the coordination and integration needed.[103] Plans, schedules, and formal rules and procedures can help ensure greater communication among divisions and with headquarters, as well as foster cooperation and synergy among far-flung units to achieve the organization's goals in a cost-efficient way. Top managers can provide clear strategic direction, guide far-flung operations, and resolve competing demands from various units.

6.4c Expanded Coordination Roles

Organizations may also implement structural solutions to achieve stronger coordination and collaboration.[104] Creating specific organizational roles or positions for coordination is a way to integrate all the pieces of the enterprise to achieve a strong competitive position. In successful international firms, the role of top *functional managers,* for example, is expanded to include responsibility for coordinating across countries, identifying and linking the organization's expertise and resources worldwide. In an international organization, the manufacturing manager has to be aware of and coordinate with manufacturing operations of the company in various parts of

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the world so that the company achieves manufacturing efficiency and shares technology and ideas across units. A new manufacturing technology developed to improve efficiency in a company's Brazilian operations may be valuable for European and North American plants as well. Manufacturing managers are responsible for being aware of new developments wherever they occur and for using their knowledge to improve the organization. Similarly, marketing managers, HR managers, and other functional managers at an international company are involved not only in activities for their location but in coordinating with their sister units in other countries as well.

Whereas functional managers coordinate across countries, *country managers* coordinate across functions. A country manager for an international firm has to coordinate all the various functional activities located within the country to meet the problems, opportunities, needs, and trends in the local market, enabling the organization to achieve multinational flexibility and rapid response. The country manager in Venezuela for a global consumer products firm such as Colgate-Palmolive would coordinate everything that goes on in that country, from manufacturing to HR to marketing, to ensure that activities meet the language, cultural, government, and legal requirements of Venezuela. The country manager in Ireland or Canada would do the same for those countries. Country managers also help with the transfer of ideas, trends, products, and technologies that arise in one country and might have significance on a broader scale. Some organizations also use *business integrators* to provide coordination on a regional basis that might include several countries. These managers reach out to various parts of the organization to resolve problems and coordinate activities across groups, divisions, or countries.

Another coordination role is that of formal *network coordinator* to coordinate information and activities related to key customer accounts. These coordinators would enable a manufacturing organization, for example, to provide knowledge and integrated solutions across multiple businesses, divisions, and countries for a large retail customer such as Tesco, Walmart, or Carrefour. Top managers in successful global firms also encourage and support informal networks and relationships to keep information flowing in all directions. Much of an organization's information exchange occurs not through formal systems or structures but through informal channels and relationships. By supporting these informal networks, giving people across boundaries opportunities to get together and develop relationships, and then ways to keep in close touch, executives enhance organizational coordination.[105]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Use mechanisms such as global teams, headquarters planning, and specific coordination roles to provide needed coordination and integration among far-flung international units. Emphasize information and knowledge sharing to help the organization learn and improve on a global scale.

6.4d Benefits of Coordination

International companies have a hard time staying competitive without strong inter-unit coordination and collaboration. Those firms that stimulate and support collaboration are typically better able to leverage dispersed resources and capabilities to reap operational and economic benefits.[106] Benefits that result from inter-unit collaboration include the following:

- *Cost savings.* Collaboration can produce real, measurable results in the way of cost savings from the sharing of best practices across global divisions. For example, at BP, a business unit head in the United States improved inventory turns and cut the working capital needed to run U.S. service stations by learning the best practices from BP operations in the United Kingdom and the Netherlands.
- *Better decision making.* By sharing information and advice across divisions, managers can make better business decisions that support their own unit as well as the organization as a whole.

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BRIEFCASE

As an organization manager, keep these guidelines in mind:

Appreciate cultural value differences and strive to use coordination mechanisms that are in tune with local values. When broader coordination mechanisms are needed, focus on education and corporate culture as ways to gain understanding and acceptance.

- *Greater revenues.* By sharing expertise and products among various divisions, organizations can reap increased revenues. BP again provides an example. More than 75 people from various units around the world flew to China to assist the team developing an acetic acid plant there. As a result, BP finished the project and began realizing revenues sooner than project planners had expected.
- *Increased innovation.* The sharing of ideas and technological innovations across units stimulates creativity and the development of new products and services. McDonald's is taking an approach called "freedom within a framework" that allows regional and national managers to develop practices and products suited to the local area. The company then makes sure international managers have plenty of both formal and informal ways to communicate and share ideas. The Big Tasty, a whopping 5.5-oz. beef patty slathered in barbeque sauce and topped with three slices of cheese, was created in a test kitchen in Germany and launched in Sweden, but as word spread, the sandwich was adopted by restaurants in places like Brazil, Italy, and Portugal, where it became a huge hit.[107]

REMEMBER THIS

- Additional coordination mechanisms to address the problem of integration and knowledge transfer are through global teams, stronger headquarters planning and control, and specific coordination roles.
- Teams can also be a good way to help resolve the tension between the desire for global uniformity and the desire for local responsiveness.
- The benefits of inter-unit coordination and collaboration for international companies include cost savings, better decision making, higher revenues, and increased innovation.

6.5 The Transnational Model of Organization

Because traditional approaches have been inadequate to meet the demands of a rapidly changing, complex global environment, many large international companies are moving toward a *transnational model* of organization, which is highly differentiated to address the increased complexity of the global environment yet offers very high levels of coordination, learning, and transfer of organizational knowledge and innovations. The **transnational model** represents the most advanced kind of international organization. It reflects the ultimate in both organizational complexity, with many diverse units, and organizational coordination, with mechanisms for integrating the varied parts. The transnational model is useful for large, multinational companies with subsidiaries in many countries that try to exploit both global and local advantages as well as technological advancements, rapid innovation, and global learning and knowledge sharing. Rather than building capabilities primarily in one area, such as global efficiency, local responsiveness, or global learning, the transnational model seeks to achieve all three simultaneously. Dealing with multiple, interrelated, complex issues requires a complex form of organization and structure.

The transnational model represents the most current thinking about the kind of structure needed by highly complex global organizations such as Philips NV, illustrated in Exhibit 6.11. Incorporated in the Netherlands, Philips has hundreds of

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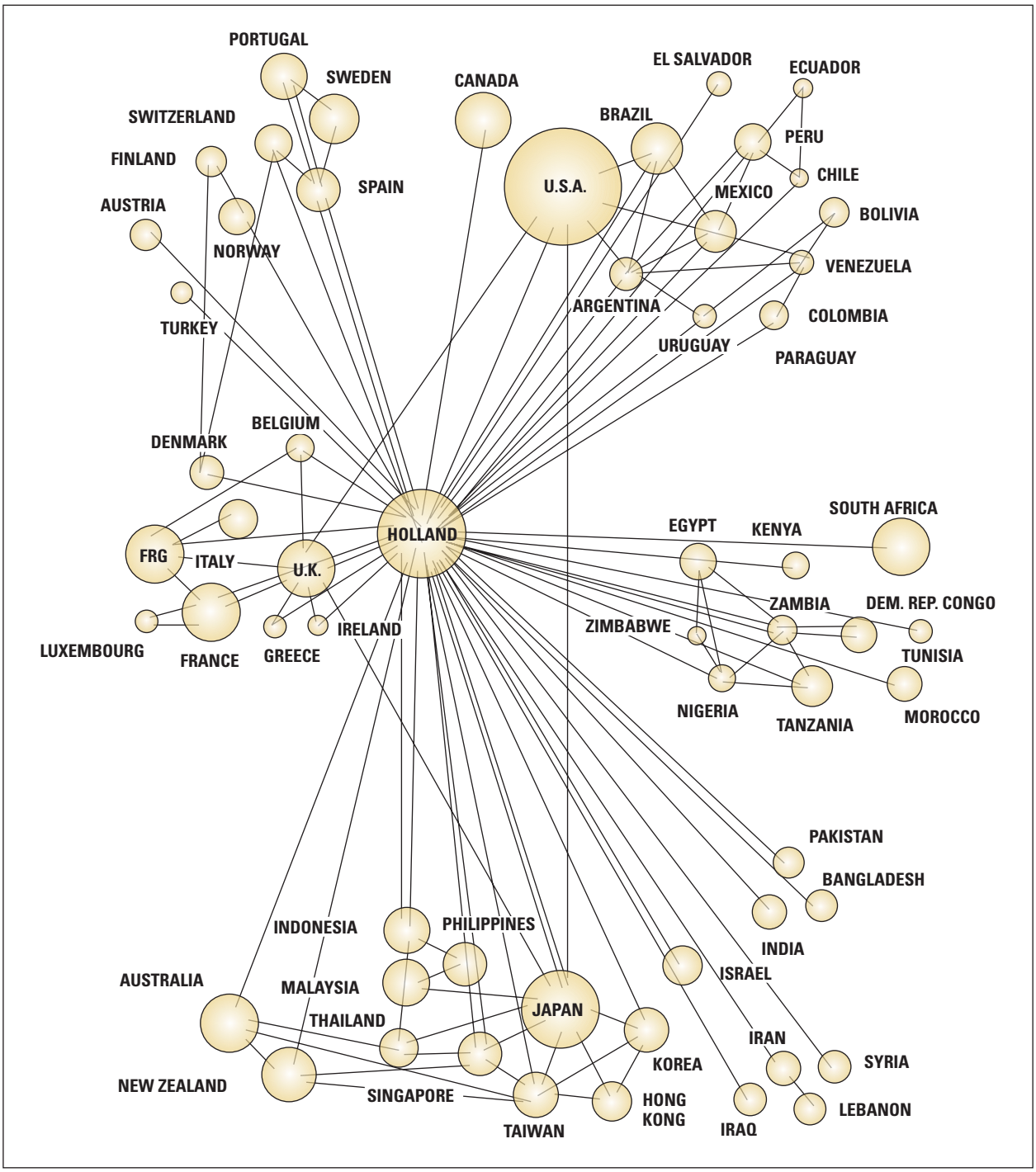
EXHIBIT 6.11

International Organizational Units and Interlinkages within Philips NV



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operating units all over the world and is typical of global companies such as Unilever, Matsushita, or Procter & Gamble.[108] Large professional service firms such as KPMG and PricewaterhouseCoopers (PwC) also use the transnational structure. PwC, for example, has more than 160,000 people in 757 offices in 151 countries. The company provides a highly diversified range of knowledge-based services that must be customized to specific clients in specific locales, so local offices need discretion and autonomy. At the same time, PwC needs consistent operating standards and control systems worldwide.[109]

The units of a transnational organization network, as illustrated in Exhibit 6.11, are far-flung. Achieving coordination, a sense of participation and involvement by subsidiaries, and a sharing of information, knowledge, new technology, and customers is a tremendous challenge. For example, a global corporation like Philips, Unilever, or PwC is so large that size alone is a huge problem in coordinating global operations. In addition, some subsidiaries become so large that they no longer fit a narrow strategic role defined by headquarters. While being part of a larger organization, individual units need some autonomy for themselves and the ability to have an impact on other parts of the organization.

ASSESS YOUR ANSWER

3 The most advanced multinational corporations have developed systems for maintaining tight headquarters control over subsidiaries in dozens of countries.

ANSWER: *Disagree.* To succeed as part of a huge global firm, individual units need flexibility and autonomy. Most of the alignment in a transnational organization is achieved through common culture and values, shared vision and goals, and interdependent relationships among subsidiaries. Managers have to stretch out of their familiar comfort zone to succeed internationally, which sometimes means giving up control in the traditional sense.

BRIEFCASE

As an organization manager, keep this guideline in mind:

Strive toward a transnational model of organization when the company has to respond to multiple global forces simultaneously and needs to promote worldwide integration, learning, and knowledge sharing.

The transnational model addresses these challenges by creating an integrated network of individual operations that are linked together to achieve the multidimensional goals of the overall organization.[110] The management philosophy is based on *interdependence* rather than either full divisional independence or total dependence of these units on headquarters for decision making and control. The transnational model is more than just an organization chart. It is a managerial state of mind, a set of values, a shared desire to make a worldwide learning system work, and an idealized structure for effectively managing such a system. The following characteristics distinguish the transnational organization from other global organization forms such as the matrix, described earlier.

1. *Assets and resources are dispersed worldwide into highly specialized operations that are linked together through interdependent relationships.* Resources and capabilities are widely distributed to help the organization sense and respond to diverse stimuli such as market needs, technological developments, or consumer trends that emerge in different parts of the world. To manage this increased complexity and differentiation, managers forge interdependent relationships among the various product, functional, or geographic units. Mechanisms such as cross-subsidiary teams, for example, compel units to work together for the good of their own unit as well as the overall organization. Rather than being

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completely self-sufficient, each group has to cooperate to achieve its own goals. At PwC, for example, the client management system connects teams of people drawn from various units, service lines, and areas of expertise around the world. Such interdependencies encourage the collaborative sharing of information and resources, cross-unit problem solving, and collective implementation demanded by today's competitive international environment. Materials, people, products, ideas, resources, and information are continually flowing among the dispersed parts of the integrated network. In addition, managers actively shape, manage, and reinforce informal information networks that cross functions, products, divisions, and countries.

2. *Structures are flexible and ever-changing.* The transnational operates on a principle of *flexible centralization.* It may centralize some functions in one country, some in another, yet decentralize still other functions among its many geographically dispersed operations. An R&D center may be centralized in Holland and a purchasing center may be located in Sweden, while financial accounting responsibilities are decentralized to operations in many countries. A unit in Hong Kong may be responsible for coordinating activities across Asia, while activities for all other countries are coordinated by a large division headquarters in London. The transnational model requires that managers be flexible in determining structural needs based on the benefits to be gained. Some functions, products, and geographic regions by their nature may need more central control and coordination than others. In addition, coordination and control mechanisms will change over time to meet new needs or competitive threats. Some companies set up multiple headquarters in different countries as the organization gets too large and too complex to manage from one place, enabling the organization to get closer to important markets. Irdeto Holdings BV, for example, has headquarters in both Hoofddorp, the Netherlands, and Beijing, and the CEO moved to China with his family. IBM created a growth-markets headquarters in Shanghai that is responsible for Asia (non-Japan), Latin America, Russia, Eastern Europe, the Middle East, and Africa. Japan's Nissan located global headquarters for its luxury Infiniti brand in Hong Kong.[111]
3. *Subsidiary managers initiate strategy and innovations that become strategy for the corporation as a whole.* In traditional structures, managers have a strategic role only for their division. In a transnational structure, various centers and subsidiaries can shape the company from the bottom up by developing creative responses and initiating programs in response to local needs, then dispersing those innovations worldwide. Transnational companies recognize each of the worldwide units as a source of capabilities and knowledge that can be used to benefit the entire organization. In addition, environmental demands and opportunities vary from country to country, and exposing the whole organization to this broader range of environmental stimuli triggers greater learning and innovation.
4. *Unification and coordination are achieved primarily through corporate culture, shared vision and values, and management style, rather than through formal structures and systems.* A study by Hay Group found that one of the defining characteristics of companies that succeed on a global scale is that they successfully coordinate worldwide units and subsidiaries around a common strategic vision and values rather than relying on formal coordination systems alone.[112] Achieving unity and coordination in an organization in which employees come from a variety of different national backgrounds, are separated by time and geographic distance, and have different cultural norms is more easily accomplished

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through shared understanding than through formal systems. Top leaders build a context of shared vision, values, and perspectives among managers who in turn cascade these elements through all parts of the organization. Selection and training of managers emphasizes flexibility and open-mindedness. In addition, people are often rotated through different jobs, divisions, and countries to gain broad experience and become socialized into the corporate culture. Achieving coordination in a transnational organization is a much more complex process than simple centralization or decentralization of decision making. It requires shaping and adapting beliefs, culture, and values so that everyone participates in information sharing and learning.

Taken together, these characteristics facilitate strong coordination, organizational learning, and knowledge sharing on a broad global scale. The transnational model is truly a complex and messy way to conceptualize organization structure, but it is becoming increasingly relevant for large, global firms that treat the whole world as their playing field and do not have a single country base. The autonomy of organizational parts gives strength to smaller units and allows the firm to be flexible in responding to rapid change and competitive opportunities on a local level, while the emphasis on interdependency enables global efficiencies and organizational learning. Each part of the transnational company is aware of, and closely integrated with, the organization as a whole so that local actions complement and enhance other company parts.

REMEMBER THIS

- Companies operating globally need broad coordination methods, and some are moving toward the transnational model of organization.
- The transnational model is based on a philosophy of interdependence. It is highly differentiated yet offers very high levels of coordination, learning, and transfer of knowledge across far-flung divisions.
- The transnational model represents the ultimate global design in terms of both organizational complexity and organizational integration. Each part of the transnational organization is aware of and closely integrated with the organization as a whole so that local actions complement and enhance other company parts.

KEY CONCEPTS

cultural intelligence
domestic stage
economies of scale
economies of scope
factors of production
global companies
global geographic structure
global matrix structure
global product structure
global stage
global teams
globalization strategy
glocalization strategy
international division
international stage
joint venture
multidomestic
multidomestic strategy
multinational stage
reverse innovation
standardization
transnational model

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DISCUSSION QUESTIONS

1. Name some companies that you think could succeed today with a globalization strategy and explain why you selected those companies. How does the globalization strategy differ from a multidomestic strategy?
2. Why do you think the tension between a desire for global uniformity and local responsiveness is greater today than in the past?
3. Many American companies enter China through joint ventures with local firms, but China is succeeding in the United States primarily with a strategy of buying companies outright. What are some factors that might account for this difference?
4. Do you think it makes sense for a transnational organization to have more than one headquarters? What might be some advantages associated with two headquarters, each responsible for different things? Can you think of any drawbacks?
5. What are some of the primary reasons a company decides to expand internationally? Identify a company in the news that has recently built a new overseas facility. Which of the three motivations for global expansion described in the chapter do you think best explains the company's decision? Discuss.
6. When would an organization consider using a matrix structure? How does the global matrix differ from the domestic matrix structure described in Chapter 3?
7. Name some of the elements that contribute to greater complexity for international organizations. How do organizations address this complexity? Do you think these elements apply to a company such as Spotify that wants to expand its music streaming service internationally? Discuss.
8. Traditional values in Mexico support high power distance and a low tolerance for uncertainty. What would you predict about a company that opens a division in Mexico and tries to implement global teams characterized by shared power and authority and the lack of formal guidelines, rules, and structure?
9. Do you believe it is possible for a global company to simultaneously achieve the goals of global efficiency and integration, national responsiveness and flexibility, and the worldwide transfer of knowledge and innovation? Discuss.
10. Compare the description of the transnational model in this chapter to the elements of organic versus mechanistic organization designs described in Chapter 1. Do you think the transnational model seems workable for a huge global firm? Discuss.

CHAPTER 6 WORKSHOP Made in the U.S.A.?

ABC World News ran a special series called "Made in America." In the opening program, correspondents David Muir and Sharyn Alfonsi removed all foreign-made products from a family's Dallas, Texas, home and found that there was virtually nothing left when they finished. How many items in your home were made in America? For this exercise, pick three different consumer products from your home (e.g., a shirt, a toy or game, a phone, a shoe, a sheet or pillowcase, a coffeemaker). Try to find the following information for each product, as shown in the table. To find this information, use websites, articles on the company from various business newspapers and magazines, and the labels on the items or user manuals. You could also try calling the company and talking with someone there.

Product	What country do materials come from?	Where is it manufactured or assembled?	Which country does the marketing and advertising?	In what different countries is the product sold?
1.				
2.				
3.				

What can you conclude about international products and organizations based on your analysis?

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CASE FOR ANALYSIS | Halogen Analytics[113]

At the age of 39, after working for nearly 15 years at a leading software company on the West Coast, Alex Schaaf and his soon-to-be-wife, Emily Rockwood, had cashed in their stock options, withdrawn all their savings, maxed out their credit cards, and started their own business, naming it Halogen Analytics. The two had developed a new software package for root cause analysis (RCA) applications that they were certain was far superior to anything on the market at that time. Halogen's software was particularly effective for use in design engineering organizations because it provided a highly efficient way to eliminate problems in new digital manufacturing processes, including product development, software engineering, hardware design, manufacturing, and installation. The software, which could be used as a stand-alone product or easily integrated with other software packages, dramatically expedited problem identification and corrective actions in the work of design engineering firms. The use of Halogen's RCA software would find an average of 30 to 50 root cause problems and provide 20 to 30 corrective actions that lowered defect rates by 50 percent, saving tens and sometimes hundreds of thousands of dollars with each application.

The timing proved to be right on target. RCA was just getting hot, and Halogen was poised to take advantage of the trend as a niche player in a growing market. Schaaf and Rockwood brought in two former colleagues as partners and were soon able to catch the attention of a venture capitalist firm to gain additional funding. Within a couple of years, Halogen Analytics had 28 employees and sales had reached nearly $4 million.

Now, though, the partners are facing the company's first major problem. Halogen's head of sales, Samantha Jenkins, has learned of a new company based in Norway that is beta testing a new RCA package that promises to outpace Halogen's—and the Norway-based company, FastData, has been talking up its global aspirations in the press. "If we stay focused on the United States and they start out as a global player, they'll kill us within months!" Sam moaned. "We've got to come up with an international strategy to deal with this kind of competition."

In a series of group meetings, off-site retreats, and one-on-one conversations, Schaaf and Rockwood have gathered opinions and ideas from their partners, employees, advisors, and friends. Now they have to make a decision—should Halogen Analytics go global? And if so, what approach would be most effective? There's a growing market for RCA software overseas, and new companies such as FastData will soon be cutting into Halogen's U.S. market share as well. Samantha Jenkins isn't alone in her belief that Halogen has no choice but to enter new international markets or get eaten alive. Others, however, are concerned that Halogen Analytics isn't ready for that step. The company's resources are already stretched to the limit, and some advisors have warned that rapid global expansion could spell disaster. Halogen isn't even well established in the United States, they argue, and expanding internationally could strain the company's capabilities and resources. Others have pointed out that none of the managers has any international experience, and the company would have to hire someone with significant global exposure to even think about entering new markets.

Although Emily tends to agree that Halogen for the time being should stay focused on building its business in the United States, Alex has come to believe that global expansion of some type is a necessity. But if Halogen does eventually decide on global expansion, he wonders how on earth they should proceed in a huge, complex world environment. Sam, the sales manager, is arguing that the company should set up its own small foreign offices from scratch and staff them primarily with local people. Building a U.K. office and an Asian office, she asserts, would give Halogen an ideal base for penetrating markets around the world. However, it would be quite expensive, not to mention the complexities of dealing with language and cultural differences, legal and government regulations, and other matters. Another option would be to establish alliances or joint ventures with small European and Asian companies that could benefit from adding RCA applications to their suite of products. The companies could share expenses in setting up foreign production facilities and a global sales and distribution network. This would be a much less costly operation and would give Halogen the benefit of the expertise of the foreign partners. However, it might also require lengthy negotiations and would certainly mean giving up some control to the partner companies.

One of Halogen's partners is urging still a third, even lower-cost approach, that of licensing Halogen's software to foreign distributors as a route to international expansion. By giving foreign software companies rights to produce, market, and distribute its RCA software, Halogen could build brand identity and customer awareness while keeping a tight rein on expenses. Alex likes the low-cost approach, but he wonders if licensing would give Halogen enough participation and control to successfully develop its international presence. As another day winds down, Schaaf and Rockwood are no closer to a decision about global expansion than they were when the sun came up.

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Questions

1. What are the arguments for Halogen Analytics going international?
2. What are the arguments for Halogen staying focused on the U.S. market?
3. Which of the three international strategy options—open its own offices, take on foreign partners, license its products—would you recommend? Explain why.

CASE FOR ANALYSIS | Rhinebeck Industrial

David Javier was reviewing the consulting firm's proposed changes in organization structure for Rhinebeck Industrial (RI). As Javier read the report, he wondered whether the changes recommended by the consultants would do more harm than good for RI. Javier had been president of RI for 18 months, and he was keenly aware of the organizational and coordination problems that needed to be corrected in order for RI to improve profits and growth in its international businesses.

Company Background

Rhinebeck Industrial was started in the 1950s in Southern Ontario, Canada, by Robert Rhine, an engineer who was an entrepreneur at heart. He started the business by first making pipe and then glass for industrial uses. As soon as the initial business was established, however, he quickly branched into new areas such as industrial sealants, coatings, and cleaners, and even into manufacturing mufflers and parts for the trucking industry. Much of this expansion occurred by acquiring small firms in Canada and the United States during the 1960s. RI had a conglomerate-type structure with rather diverse subsidiaries scattered around North America, all reporting directly to the Ontario headquarters. Each subsidiary was a complete local business and was allowed to operate independently so long as it contributed profits to RI.

During the 1970s and 1980s, the president at the time, Clifford Michaels, brought a strong international focus to RI. His strategy was to acquire small companies worldwide with the belief that they could be formed into a cohesive unit that would bring RI synergies and profits through low cost of manufacturing and by serving businesses in international markets. Some of RI's businesses were acquired simply because they were available at a good price, and RI found itself in new lines of business such as consumer products (paper and envelopes) and electrical equipment (switchboards, light bulbs, and security systems), in addition to its previous lines of business. Most of these products had local brand names or were manufactured for major international companies such as General Electric or Corning Glass.

During the 1990s, a new president of RI, Sean Rhine, the grandson of the founder, took over the business and adopted the strategy of focusing RI on three lines of business—Industrial Products, Consumer Products, and Electronics. He led the acquisition of more international businesses that fit these three categories and divested a few businesses that didn't fit. Each of the three divisions had manufacturing plants as well as marketing and distribution systems in North America, Asia, and Europe. The Industrial Products division included pipe, glass, industrial sealants and coatings, cleaning equipment, and truck parts. The Electronics division included specialty light bulbs, switchboards, computer chips, and resistors and capacitors for original equipment manufacturers. Consumer Products included dishes and glassware, paper and envelopes, and pencils and pens.

Structure

In 2010 David Javier replaced Sean Rhine as president. He was very concerned about whether a new organization structure was needed for RI. The current structure was based on three major geographic areas—North America, Asia, and Europe—as illustrated in Exhibit 6.12. The various autonomous units within those regions reported to the office of the regional vice president. When several units existed in a single country, one of the subsidiary presidents was also responsible for coordinating the various businesses in that country, but most coordination was done through the regional vice president. Businesses were largely independent, which provided flexibility and motivation for the subsidiary managers.

The headquarters functional departments in Ontario were rather small. The three central departments—Corporate Relations and Public Affairs, Finance and Acquisitions, and Legal and Administrative—served the corporate business worldwide. Other functions such as HR management, new product development, marketing, and manufacturing all existed within individual subsidiaries and there was little coordination of these functions across geographic regions. Each business devised its own way to develop, manufacture, and market its products in its own country and region.

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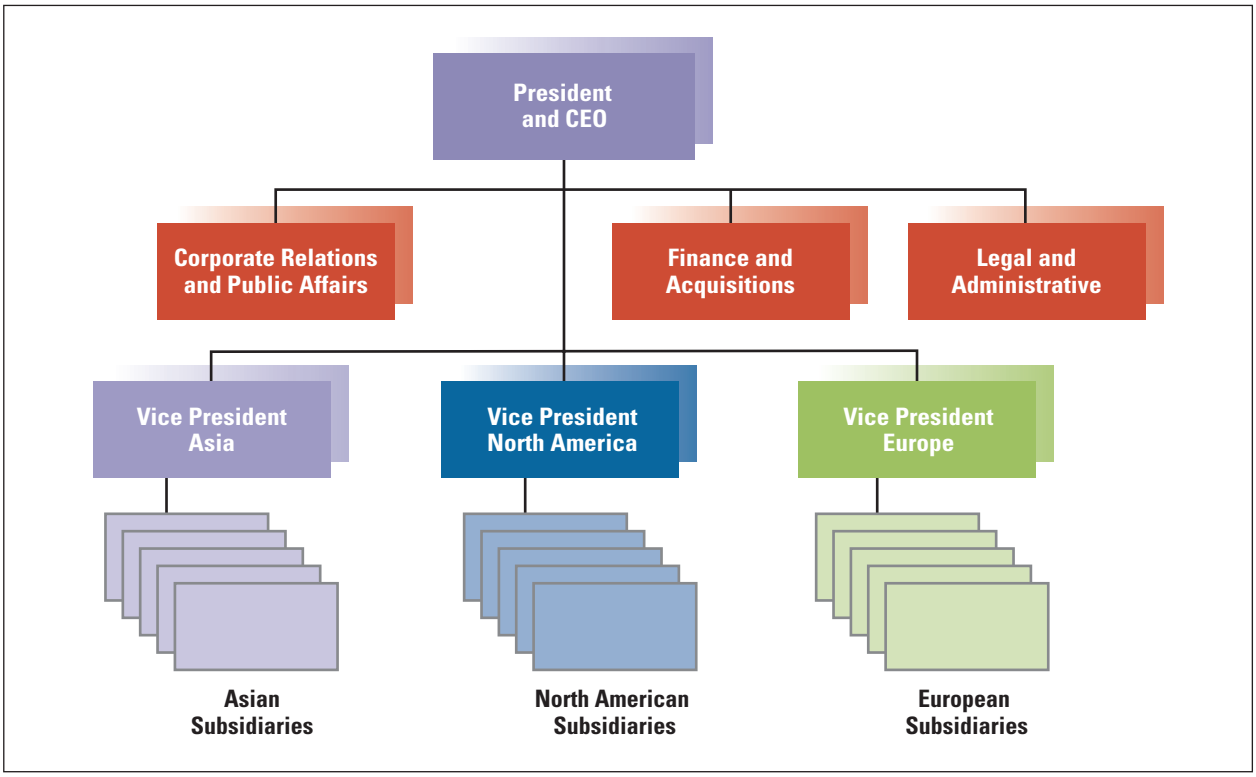
EXHIBIT 6.12
Rhinebeck Industrial Organization Chart



Organizational Problems

The problems Javier faced at RI, which were confirmed in the report on his desk, fell into three areas. First, each subsidiary acted as an independent business, using its own reporting systems and acting to maximize its own profits. This autonomy made it increasingly difficult to consolidate financial reports worldwide and to gain the efficiencies of uniform information and reporting systems.

Second, major strategic decisions were made to benefit individual businesses or for a country's or region's local interests. Local projects and profits received more time and resources than did projects that benefited RI worldwide. For example, an electronics manufacturer in Singapore refused to increase production of chips and capacitors for sale in the United Kingdom because it would hurt the bottom line of the Singapore operation. However, the economies of scale in Singapore would more than offset shipping costs to the United Kingdom and would enable RI to close expensive manufacturing facilities in Europe, increasing RI's efficiency and profits.

Third, there had been no transfer of technology, new product ideas, or other innovations within RI. For example, a cost-saving technology for manufacturing light bulbs in Canada had been ignored in Asia and Europe. A technical innovation that provided homeowners with cell phone access to home security systems developed in Europe had been ignored in North America. The report on Javier's desk stressed that RI was failing to disperse important innovations throughout the organization. These ignored innovations could provide significant improvements in both manufacturing and marketing worldwide. The report said, "No one at RI understands all the products and locations in a way that allows RI to capitalize on manufacturing improvements and new product opportunities." The report also said that better worldwide coordination would reduce RI's costs by seven percent each year and increase market potential by 10 percent. These numbers were too big to ignore.

Recommended Structure

The report from the consultant recommended that RI try one of two options for improving its structure. The

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first alternative was to create a new international department at headquarters with the responsibility to coordinate technology transfer and product manufacturing and marketing worldwide (Exhibit 6.13). This department would have a product director for each major product line—Industrial, Consumer, and Electronics—who would have authority to coordinate activities and innovations worldwide. Each product director would have a team that would travel to each region and carry information on innovations and improvements to subsidiaries in other parts of the world.

The second recommendation was to reorganize into a worldwide product structure, as shown in Exhibit 6.14. All subsidiaries worldwide associated with a product line would report to the product line business manager. The business manager and staff would be responsible for developing business strategies and for coordinating all manufacturing efficiencies and product developments worldwide for its product line.

This worldwide product structure would be a huge change for RI. Many questions came to Javier's mind. Would the subsidiaries still be competitive and adaptive in local markets if forced to coordinate with other subsidiaries around the world? Would business managers be able to change the habits of subsidiary managers toward more global behavior? Would it be a better idea to appoint product director coordinators as a first step or jump to the business manager product structure right away? Javier had a hunch that the move to worldwide product coordination made sense, but he wanted to think through all the potential problems and how RI would implement the changes.

EXHIBIT 6.13
Proposed Product Director Structure

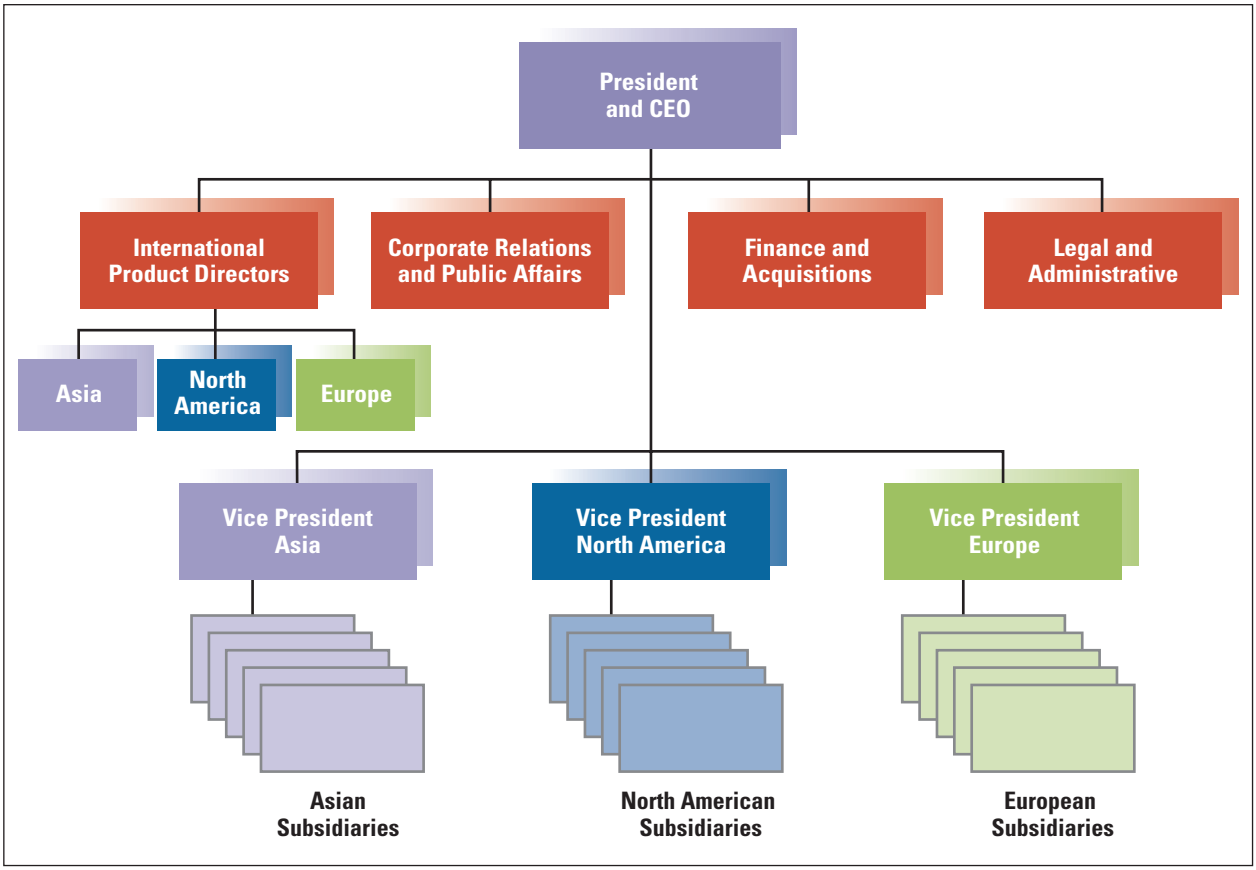

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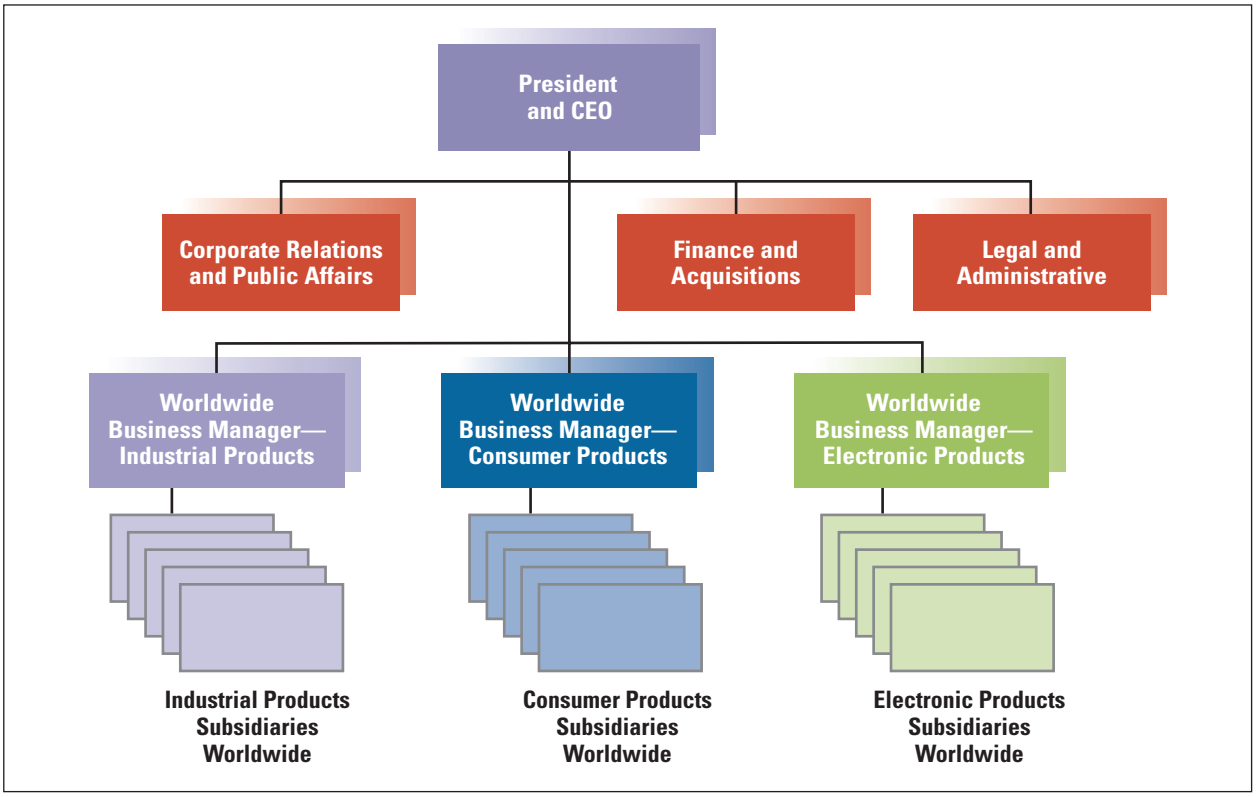
EXHIBIT 6.14
Proposed Worldwide Business Manager Structure



Questions

1. Which of the three organizational problems—separate reporting systems, business self-interest, no technology transfer—would you address first? Explain.
2. What do you see as the pros and cons of a new headquarters' international department to coordinate across geographic regions?
3. Do you support the proposal to reorganize into a worldwide product structure? What implementation challenges do you foresee? Explain.

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CHAPTER

7 Designs for Societal Impact: Dual-Purpose Organizations, Corporate Sustainability, and Ethics

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Learning Objectives

After reading this chapter you should be able to:

1. Describe how a hybrid organization differs from a typical nonprofit or profit-seeking organization, including the two major "logics" that are embraced in hybrid organizations.
2. Describe how organizations implement corporate social responsibility using the green movement, the triple bottom line, conscious capitalism, and the bottom of the pyramid approaches.
3. Identify important stakeholders for an organization and discuss how managers balance the interests of various stakeholders.
4. Discuss how ethical norms can be maintained through organizational structures and systems.
5. Compare the various sustainability approaches organizations can adopt.

Chapter Outline

Designing the Dual-Purpose Organization

Facing the Challenge · Designs for Achieving Dual Commercial and Social Welfare Goals

Corporate Social Responsibility

The Green Movement · The Triple Bottom Line · Conscious Capitalism · Serving Organizational Stakeholders · Serving the Bottom of the Pyramid

The Consequences for Doing Good

Designing a Structure for Executing a Sustainability Program

A Separate Department or Include Everyone? · Involve External Stakeholders · Set Goals, Measure, and Reward

Designs to Uphold Ethical Values

Sources of Individual Ethical Principles · Organizational Ethics · Formal Structure and Systems

Corporate Ethics in a Global Environment

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **The best way for an organization to positively address a societal problem while at the same time succeeding as a business is to incorporate as a benefit corporation.**

I AGREE _____ **I DISAGREE** _____

2 **The most important stakeholders for any corporation that wants to succeed are its shareholders.**

I AGREE _____ **I DISAGREE** _____

3 **The single best way to make sure an organization stays on solid ethical ground is to have a strong code of ethics and make sure all employees are familiar with its guidelines.**

I AGREE _____ **I DISAGREE** _____

What kind of company wants people to *not* buy its products? In an unusual move, Patagonia ran a full-page ad on "Black Friday" as part of its Worn Wear campaign, encouraging people to forego buying new clothing. The company offered free repairs for its apparel to encourage customers to repair the clothes they had to help save the environment rather than purchase new ones. Sales on Black Friday for the outdoor gear and apparel firm rose 42 percent. Patagonia lives up to its mission statement of "using business to inspire and implement solutions to the environmental crisis." The company donates 10 percent of pretax profits or one percent of sales, whichever is higher, to groups working to save the environment. In another unusual move in the early 1990s, Patagonia began freely sharing its R&D for environment-saving manufacturing technology and know-how with anyone, even its competitors.

Why is Patagonia so concerned with the environment? Founder Yvon Chouinard was devoted to mountain climbing adventures throughout his life. The founder's values and philosophy are embedded in the Patagonia culture. He initially made a living selling climbing gear out of the trunk of his car, which evolved into a billion-dollar business. Chouinard's concern for nature was always stronger than his concern for business. He named his business Patagonia after the rugged mountainous region in southern Argentina.

To ensure a lasting focus on the environment, Patagonia was re-registered to become a "certified benefit corporation," sometimes also known as a "B corp." These are for-profit companies designed to pursue social goals as well as business goals, and they are legally enabled to allocate profits to a social mission rather than assigning profits to shareholders.[1]

At this point in history, nearly all companies are aware of the need for sustainability, and most have sustainability programs. Corporations are reducing carbon emissions, developing environmentally friendly products, and recycling to reduce waste. Although most companies do not go as far as Patagonia by becoming legal benefit corporations, they are responding to the pressure to change from a single-minded pursuit of financial gain. More companies are paying attention to their impact on employees, customers, communities, and the environment.

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Images of plastic bottles and food containers overflowing landfills and threatening ocean life have made people aware of the damage disposable plastic is doing to the natural environment. Bottled water producers are working to find alternatives in response to a consumer backlash against plastic. Many offices, zoos, department stores and other public spaces have stopped selling bottled water. Some cities have banned the use of plastic straws and eating utensils. Starbucks redesigned its cold drink lids to eliminate the need for plastic straws.[2]

Other organizations are also heeding the pressure to consider sustainability issues. In the United States, companies as diverse as Tiffany and Walmart are incorporating sustainability goals. As Frederic Cumenal, former CEO of Tiffany & Company, said, "Younger people increasingly care where their food is harvested, so we think they'll care about the provenance of their diamonds, too." Tiffany began a push toward sustainability 25 years ago. The company refuses to buy so-called "conflict diamonds," stones that originate in countries with political conflicts and human rights abuses, and was one of the first companies to stop using coral in jewelry.[3] Internationally, Unilever in Europe and the Siam Cement Group in Asia are models of companies pursuing dozens of sustainability initiatives. Indeed, most established profit-seeking organizations are adding new sustainability tactics as part of their corporate sustainability efforts. Moreover, a growing number of businesses such as Patagonia are founded with the dual purpose of serving the environment while also making sufficient profit to sustain the company.

Purpose of This Chapter

The purpose of this chapter is to explore how to design organizations to incorporate strong sustainability goals that will persist in the face of financial pressures to maximize profits. We first define the hybrid organization, describe various approaches to designing organizations to achieve dual commercial and societal benefit goals, and discuss the problem of mission drift and the two opposing logics that may conflict in a hybrid organization. The chapter then looks at the growing importance of corporate social responsibility in traditional organizations, including a discussion of sustainability and the green movement, the triple bottom line, conscious capitalism, and the stakeholder approach. This section also includes a look at how large corporations are serving the world's poorest citizens, a concept called serving the bottom of the pyramid. Succeeding sections examine how to design a structure for a sustainability program, look at the relationship between corporate social responsibility and financial performance, and consider how managers implement the structures and systems that influence ethical and socially responsible behavior. The chapter closes with a brief discussion of the complex ethical issues managers face in the international environment.

7.1 Designing the Dual-Purpose Organization

Social enterprises are typically founded with the purpose of addressing a societal problem while at the same time succeeding as a business in order to finance the social mission. The term **hybrid organization** means to pursue both profit

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and social missions within a single organization.[4] A hybrid tries to be financially self-sufficient like a business, while at the same time spending its profits to create a positive impact on a social or environmental problem. Serving two major and competing purposes presents a serious challenge for organization designers. It is much easier to establish an organization to seek profits or as a nonprofit serving a social good. Doing both presents a challenge because one goal may take priority over the other, which will likely trigger the organization's demise.

Although hybrid social enterprises are initiated for the creation of both social and commercial outcomes, they face the risk of **mission drift**, which means giving less importance to their social mission and more importance to generating revenue and profit. Mission drift in hybrids arises when people in the hybrid become more concerned with creating value for their paying customers, to the detriment of providing value to their nonpaying social beneficiaries (such as poor children who receive schooling or the long term unemployed). The risk of mission drift in hybrids is high. Managers and employees depend on commercially-generated revenue to sustain their operations and their jobs. It is natural to gradually give priority to the commercial activities that mean survival, to the detriment of the social benefit activities. The consequence of mission drift for social enterprises is severe because it threatens their reason for existence. When a hybrid loses sight of its social mission, it will fail to achieve the goal of delivering social value that resolves a social or environmental problem. Managers in hybrid organizations thus have to learn how to give equal balance to the organization's social and commercial activities, which means generating sufficient revenues without losing sight of their social purpose.[5]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Guard against mission drift. Give equal attention to the hybrid organization's social and commercial activities so that the enterprise can generate sufficient revenues without losing sight of its social purpose.

At one time, business organizations were completely separate from the nonprofits and philanthropic organizations that addressed social problems. The nonprofit organizations gained resources via fundraising, and businesses earned profits for shareholders. In recent years, many nonprofits have wanted to become self-sustaining rather than depending on outside donors for survival. Business organizations have felt the need to do more for society. Thus, the pressure for organizations to be both financially viable and socially responsible has pushed both for-profit companies and nonprofit organizations into a hybrid zone in which creating both social and financial value are part of the core business.

A corporation validly incorporated for social benefit can be formed in two ways: through direct incorporation in states that recognize benefit corporations as legal entities, or through certification by B Lab, a nonprofit organization that specializes in external social impact auditing. In addition, a company doesn't need a specific legal status in order to work toward both financial goals and positive social contributions. As the CEO of Unilever put it, "I don't believe you have to be a B Corp to behave like one."[6] The movement toward a more hybrid-like approach has taken different names, such as dual-purpose, shared value, conscious capitalism, social entrepreneurship, benefit corporations, and B corporation certification, as defined in Exhibit 7.1. Although specific aspects of each type do vary, each organization form and philosophy is intended to create something of financial value that also has positive social impact.

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EXHIBIT 7.1
Organizational Approaches for Societal Benefit

Term	Description
Benefit corporation	A legal for-profit entity whose charter includes legal responsibility for positive social or environmental goals in addition to profit-seeking goals.
B Corporation	An organization that has received a private certification issued by B Lab, based on an 80-item assessment of accountability and transparency in social and environmental performance. Often used in locations where legal government chartering as a benefit corporation is not available.
L3C – Low profit limited liability company	A legal structure used in a few states that allows for investment in socially responsible enterprises that are for-profit.
Shared Value Approach	Business practices that increase the competitiveness of a company and at the same time contribute to positive economic and social impact in the community.
Bottom of the pyramid ventures	Corporate approach of expanding business by creating products or services to serve poorer populations.
Conscious Capitalism	Concerned with social and environmental issues both at a local and global level. Awareness of the impact of products and services on people and the environment.
Social Entrepreneurship	Founding a profit-seeking new business venture with the goal of tackling a specific societal problem while earning enough profit to sustain the business.
Social Enterprise	An established hybrid business with the dual goals of addressing a societal problem and making a profit.

Source: Based on Solange Hai and Richard L. Daft, "When Missions Collide: Lessons from Hybrid Organizations for Sustaining a Strong Social Mission," *Organization Dynamics* 45 (2016), 283–290.

7.1a Facing the Challenge

The sports shoe company AND1 was founded with the dual goals of serving people and planet along with making a profit. Charitable activities and sustainability were absolutely core to the company's business. The company provided generous employee benefits, including parental leave, a basketball court, and yoga classes. Five percent of its profit (about $2 million) was donated to local charities that focused on urban education and youth leadership development. Company managers worked closely with suppliers overseas to ensure high health and safety standards and fair wages. AND1 became number two in basketball shoes in the early 2000s. Competition was also stiffening in the retail shoe industry, so the company faced employee layoffs. When AND1 was acquired by another company, the new owners did not embrace its social goals. Many of the social and environmental programs were dismantled as the company began to focus almost solely on profit-driven goals and activities.[7]

The AND1 example shows how fragile a social mission can be in a profit-seeking business. The profit mission obliterated the social mission. Why do these two missions so often produce internal company strife and conflict? Below the surface of the company's twin missions are employees' personal beliefs, values, and preferences, which are call logics. A **logic** means a person's basic assumptions, values, and beliefs that he or she thinks should guide an organization's behavior. These values

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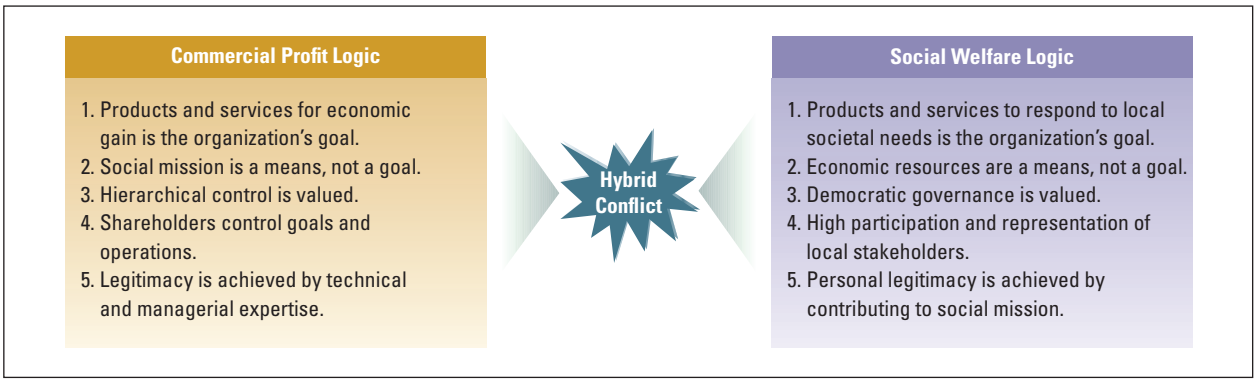
and beliefs give meaning to people's daily lives. Moreover, people usually believe their logic is correct and should take precedence over other logics. The notion of a deeper logic explains why deeply embedded conflicts arise in a hybrid organization. Peoples' logics reflect beliefs and values that they want to see in their work practices and organizational purposes. These logics often put some people on one side and some on the other side of the divide between social versus profit outcomes, creating conflict within a hybrid organization. Logics are not about job satisfaction; they are deeper and typically are brought to work as part of one's life values.

In the case of hybrid organizations, two main logics are typically at play—the commercial logic and the social welfare logic. These logics function with very different assumptions as illustrated in Exhibit 7.2. The commercial logic focuses on selling products and services for economic gain or profit. In this perspective, the obvious primary goal is profit, while a social mission would be considered only a secondary means to achieve profit. The structure of control is hierarchical, with major decisions around goals and operations made to serve shareholders. In the logic of commerce, the legitimacy of a company is based on technical and managerial expertise to beat the competition. The commercial logic is taught in business schools and has a strong presence in the business community. A vivid example of commercial logic occurred when pharmaceutical firms in the United States were criticized for charging high prices. A spokesperson for one firm defended the price increases by saying: "Our duty is to our shareholders and to maximize the value of products we sell."

On the other hand, the social welfare logic sees the selling of company products and services as merely a mechanism for responding to societal needs. Products, services, and profit are by no means primary. They are a means to achieve a higher social goal and are not a goal in themselves. The social welfare logic involves the inclusive participation of local stakeholders inside and outside the organization. Governance in the social welfare logic is democratic. Legitimacy is achieved through contribution and commitment to the social mission. The social logic is partly captured by John Mackey of Whole Foods, who said, "Just as people cannot live without eating, so a business cannot live without profits. But most people don't live to eat, and neither must businesses live just to make profits."

EXHIBIT 7.2
The Two Opposing Logics Embedded Within a Hybrid Organization


Commercial Profit Logic
1. Products and services for economic gain is the organization's goal.
2. Social mission is a means, not a goal.
3. Hierarchical control is valued.
4. Shareholders control goals and operations.
5. Legitimacy is achieved by technical and managerial expertise.
Hybrid Conflict
Social Welfare Logic
1. Products and services to respond to local societal needs is the organization's goal.
2. Economic resources are a means, not a goal.
3. Democratic governance is valued.
4. High participation and representation of local stakeholders.
5. Personal legitimacy is achieved by contributing to social mission.

Source: Based on Solange Hai and Richard L. Daft, "When Missions Collide: Lessons from Hybrid Organizations for Sustaining a Strong Social Mission," *Organization Dynamics* 45 (2016), 283–290.

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Dealing with these opposing logics within the same organization and keeping them evenly balanced is a major challenge in a hybrid organization. These logics, both commercial and social, can clash on a daily basis. Employees on both sides have their assumptions and principles, both believe their mission is a priority over the other, and yet they need each other to survive. A recent study looked at how the 2,000 or so members and employees of a natural foods co-op manage their duality of values: (1) idealistic values with primary focus on social justice and ethical products, and (2) pragmatic values with primary focus on growth, product demand, and profit. Two cliques began to form around the two basic values, and defensiveness arose between the groups. Some members aligned with economic efficiency, and others aligned with quality for people. The members found that getting to a workable compromise was difficult because it meant compromising one's own deeply held life beliefs and values. The respective values were so deeply ingrained that compromising with the other side was almost like negating one's own life purpose and values.[8]

7.1b Designs for Achieving Dual Commercial and Social Welfare Goals

Hybrid organizations have genuine value for addressing long-standing societal problems. For example, micro-finance institutions have allowed 91 million people living in poverty to access $81 billion in small loans, thereby increasing their economic prosperity. Fair trade organizations that benefit small producers in developing countries have generated over $5 billion in annual sales worldwide, thereby improving the economic conditions of 1.4 million small producers. In France, the hybrids that help long-term unemployed people provided jobs for 15,000 long-term unemployed individuals. Although social benefits can be great, the internal tensions and mission drift within hybrids can make it difficult to maintain both financial sustainability and delivery of social benefits.[9]

Research shows that various structures and techniques can be used for organizing people who hold opposing mindsets and values about an organization's purpose. These structures include separating people into distinct departments, careful employee selection, and a strong leadership role.

When to Use Separate Departments. There are two options for organizing people to achieve the dual goals of a social hybrid organization. Managers can choose to put everyone in a single department within which all employees actively work toward both social welfare and profit goals, called an *integrated structure*. A second option is to organize hybrid employees into a structure with two separate departments depending on the nature of the workflow and clients. In general, when the work divides readily into separate parts, each of which requires a different value logic, then separate departments are more effective. If the work is a series of tasks producing a single outcome, then integrating employees into a single unit can be effective while also achieving greater efficiency. The following examples illustrate this concept.[10]

A French company had an overall goal of retraining and integrating long-term unemployed people into the job market. This process entailed distinct activities—first, training people to collect and repair used appliances for resale in secondhand shops, and second, providing personal support in how to look for a job, handle a

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job interview, and write a resumé. The repair and resale of appliances involved technical activities that added economic value by bringing in profits. The assistance to increase participants' ability to find jobs created social value that actually increased costs and reduced profit. When company founders tried combining everyone into a single department to do the two jobs—giving participants technical guidance and providing them with social support—they had a hard time finding supervisors and employees with both social and technical concern and expertise. Employees tended to tilt one way or the other based on past experience and personal values. The founders then set up separate organizational units, with one unit for appliance repair overseen by technical experts, and one unit for providing social support facilitated by social workers. Assigning people into separate departments based on their logics and expertise was an effective structure. Thus, this company learned over time that dividing the two major activities (profit, social welfare) into separate departments was key to effectiveness.[11]

Revolution Foods, on the other hand, found that combining people in a single department worked just fine. Revolution was founded to provide nutritious lunches to low-income students in the United States. Its primary purpose was to provide better food options to children in underfunded schools. Supplying a healthy meal is the single activity that enhances both a child's welfare and turns a profit for Revolution. In this case relevant employees were brought together in a single department, with a single manager in charge of both operational efficiency and the promotion of child well-being. The same employees who produced and delivered the food were also able to engage students in nutrition education, introduce new foods, and collect feedback on taste.[12]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

If the work in a hybrid organization involves a series of tasks that produce a single outcome, organize all employees in a single department to gain efficiency. When work activities divide readily into separate parts that require different value logics, use separate departments to maintain a balance between the commercial logic and the social welfare logic.

Hire Employees with a Balanced Mindset. Since hybrid organizations are a relatively new phenomenon, the pool of employees experienced enough to help maintain a good balance is relatively limited. A recent study looked at loan officer hiring practices at a micro-finance institution in Bolivia called BancoSol. Micro-finance is a type of banking service provided to unemployed or low-income people who have no other access to loans for starting small businesses or other banking services. When hiring local officers for the social welfare mission, it was difficult to find people with a balanced perspective. Loan officers needed to be able to evaluate potential borrowers' ability to repay the loan, determine the size of the loan, and collect on loans, all of which reflect a commercial banking logic. On the other hand, loan officers also needed to effectively interact with people from under-served populations, make regular visits to the communities, and speak local indigenous languages, activities aligned with a social welfare logic. BancoSol already had a foundation of social workers, sociologists, and religious workers with extensive experience in the social mission. Hence the bank started hiring people with a traditional background in finance and economics to counterbalance the strong team that was socially focused. Keeping the respective groups evenly balanced was a major challenge. The commercial logic and the social logic clashed on a daily basis. Employees on both sides held onto its assumptions and principles. BancoSol did not become as efficient and influential in its communities as originally hoped, largely because village clients had different employees calling on them voicing different perspectives.[13]

Another micro-finance institution in Bolivia, Los Andes, adopted a different approach to hiring loan officers. Rather than hiring people with either social or banking experience, the organization decided it could more easily socialize

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people with little or no work experience into the mental logics that would best serve its village clientele. When adding new employees, the bank prioritized on-the-job learning for both technical and social expertise and dedicated significant resources to a balanced training program. The bank's leaders believed that only a long-term perspective would ensure the ability to blend the social and commercial banking logics needed within the organization. This broader perspective created a common and balanced identity among the loan officers to successfully achieve both financial and social aspects of villager relationships to complete successful loans.[14]

Set Clear Goals and Measure Effectiveness. As described in Chapter 2 of this text, setting clearly defined goals and measures of effectiveness is an important organizational design tool. Goals communicate what matters and measurement indicates what is working and not working. Poor goal-setting and inadequate or unsuitable performance measures can throw the organization out of whack. Moreover, getting the right balance between financial and social impact measurements can be tricky. It is relatively easy to measure the financial side of the organization. Financial indicators such as sales, revenue growth, and return on assets have readily accessible and widely accepted metrics. Measuring social impact is more challenging. Precise goals are more difficult to define, and quantitative data are harder to obtain. More work and research are typically needed to set social impact goals and measure their accomplishment.[15] Managers in hybrid organizations often must experiment to find the most effective goal setting and measurement process. The experience of managers at Grameen Veolia Water illustrates the challenge managers face setting and measuring goals in hybrid organizations.

IN PRACTICE

Grameen Veolia Water

Grameen Veolia Water was founded with the mission to provide safe, affordable drinking water to the poor inhabitants of rural villages in Bangladesh. The organization also established a second purpose: to sustain company operations from sales of water rather than having to rely on soliciting government grants. Both goals were important because selling water to poor rural households at a very low price (social goal) did not provide enough revenue to cover expenses. So, the company started selling water in jars to schools and businesses in nearby urban areas (profit goal). When Grameen started making large profits from the sale of water, the social mission and the business mission came into conflict. Managers felt a strong temptation to drift toward the profitable outcome. However, top leaders held tight and kept the focus on the clearly stated social goal to remind everyone that profitable urban sales were meant to subsidize the important low-priced sales to villagers.

Grameen Veolia Water managers found that clear and specific goals and measurements helped maintain the balance between profit and social purposes. They worked hard to establish comparable social and profit goals and measurements. Consulting with experts along with members of the rural communities, Grameen formalized four key performance indicators (KPIs): (1) the percentage of the company's investments in water for rural areas made from its own resources, (2) the rate of penetration into rural areas, (3) the rate of rural regular water consumption, and (4) the number of villagers having access to its water services. These excellent goals and measurements reinforced both the social and profit goals.[16]

Collaborate with Like-Minded Organizations. One of the interesting findings from inter-organizational research, described in Chapter 5, is that organizations tend to develop "institutional similarity" with their significant partners in the same

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organizational population or value chain. Although the number of hybrid organizations is growing, many of the companies pursuing dual missions are still on the periphery trying to gain market share. They will face subtle pressure to mimic the systems and values of the companies with which they do significant business. Hybrid organization leaders need a clear focus on whom they work with, including customers, suppliers, and employees.

A good example is Ben & Jerry's, whose founders have always felt strongly about the company's environmental values. They saw their new business as an opportunity to work closely with customers and suppliers who aligned with or would be influenced to share Ben & Jerry's social mission. One of the founders said, "we knew we were never going to get 100 percent market share anyway, so we felt it was better to build these very strong bonds with people over shared values." One way they implemented shared values was by urging their suppliers to become more transparent about their social and environmental agenda and missions. Choosing like-minded suppliers helped them maintain Ben & Jerry's value-driven approach.

Managers at Patagonia, described in the chapter opening example, also want to work with like-minded organizations, and the company is trying to use its leverage to influence other organizations to be more environmentally responsible. For some time, wearing co-branded custom fleece and down vests from Patagonia, sometimes called the "Power Vest," has been all the rage among Wall Street business and finance employees. Michael Antonelli, a market strategist at investment bank Robert W. Baird & Company said, "I'll die on a hill with it" to describe his attachment to the vest. However, in the spring of 2019, Patagonia announced a rule that would limit new orders of the co-branded vests to "mission-driven companies that prioritize the planet." That means any new company wanting to order the trendy vests must convince Patagonia that they are in some way helping preserve the environment.[17]

Keep the Social Mission Alive in the Minds of Employees. If leaders keep the social mission alive in every employee's mind, they can minimize the potential conflicts between employees with different logics. Many employees, especially younger ones, are looking for jobs where they feel the work is meaningful and goes beyond just making money. The website Change.org, a petition tool for campaigns and causes, understands that people want meaningful work, a workplace where they can grow professionally, and to be surrounded by people they can learn from. Change.org leaders believe that a hybrid organization can offer those non-monetary benefits to employees. They gain employee buy-in to the social mission by hiring sympathetic people and then providing their employees with incentives that take the form of "lifestyle" investments—flexibility to dictate their own work, and work/life balance initiatives (e.g., gym memberships, theater sponsorships).[18]

The Container Store, a specialty retailer selling storage and organizing products, provides another example. CEO Kip Tindall and other leaders consider sharing the wealth with employees "the best way to make money." Tindall gains buy-in to social values by paying employees well and treating them with respect. The Container Store calls its business model, "business without trade-offs." Employees are first trained on the foundational principles of the company, so they feel very connected to The Container Store. Always thinking about social mission buy-in, Tindall renamed Valentine's Day "We Love our Employees Day," and managers gave gifts to employees to show that love. "I enjoy making money

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BRIEFCASE

As an organization manager, keep these guidelines in mind:

Hire people who demonstrate a balanced mindset, and keep employees focused on clearly defined goals so the profit motive doesn't overwhelm the social motive in a hybrid organization. Strive to work with suppliers and other partners that align with the values and social mission of the organization.

for myself and the people around me. I'm not saying this is the only way to make money. I'm saying this is the best way," says Tindall, showing how creating benefit for employees also benefits customers and suppliers as the best way to create value for the company.[19]

Choose the Correct Legal Framework. Companies in the United States can now incorporate (or re-incorporate, as Patagonia did) with a legal structure that recognizes social and environmental missions as equally important to financial goals. A **benefit corporation**, now authorized in at least 21 states and the District of Columbia, is a for-profit entity that specifies positive social and environmental impact as well as profit in its legally chartered goals. The purpose of a benefit corporation is to create public benefit in terms of a positive material impact on society and the environment. For example, Berrett-Koehler Publishers was the first publishing company to re-incorporate as a benefit corporation, with leaders saying they wanted to "put the force of law behind Berrett-Koehler's long-standing social mission values, practices, and objectives."[20] A benefit corporation can choose to prioritize a social or environmental goal over financial benefit to shareholders without risk of lawsuits by shareholders. To become a benefit corporation, the company must include in its charter specifically what it is doing to aid the public and society. The benefit corporation also enables companies to lock in the legal structure for future generations. The possibility of having a legal charter that protects non-financial goals is something that would have helped AND1 shoe company, described earlier, maintain its social programs, which were dismantled after the company was acquired. Another option in a few states is the L3C low profit limited liability company that allows the organization to emphasize social goals and low profit.

Kickstarter, the popular crowdfunding platform for startups, re-incorporated itself as a benefit corporation. The co-founders wanted to ensure that the profit logic does not overwhelm the social mission of the platform, thereby enabling novel and creative social entrepreneurial projects to be funded into the future. In addition to this social mission, the company donates five percent of its profit to arts and equality causes. The co-founders are clear on their vision of rejecting the idea of Kickstarter ever being acquired or going public because they do not want to put the organization in a position where decisions are made only for profit rather than for the social goals of the company.

Social enterprises often have to experiment to find the correct legal structure to support both social and financial goals. In a few cases, a hybrid organization might even include separate nonprofit and for-profit legal structures to accomplish its dual goals. For example, Runa is a hybrid organization that produces Guayasa beverages for profit and supports Ecuadorian farmers as a social goal. Ecuadorians have long made a drink from the caffeinated leaves of the Guayasa trees found in the Ecuadorian Amazon. However, development projects to support Ecuadorian farmers were ineffective and increased deforestation. Runa's CEO devised separate for-profit and nonprofit organizations to support the social mission. The for-profit branch focuses on building an effective supply chain for making and selling Guayasa drinks. The nonprofit focuses on social-economic research and program development, reforestation, and agricultural research in conjunction with the farmers. The for-profit earnings support the social mission of the nonprofit.[21]

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REMEMBER THIS

- A hybrid organization is one that pursues both profit and social missions within a single organization.
- People hold different assumptions, values, and beliefs, called *logics*, that they think should guide how the organization behaves.
- The commercial logic considers company products and services for economic gain as the primary goal.
- The social welfare logic sees company products, services, and profit as a means to achieve a higher social purpose and not as a goal in themselves.
- These opposing logics can clash. Keeping them evenly balanced is a major challenge for managers in a hybrid organization.
- Effective structures and techniques managers can use for organizing people who hold opposing mindsets and values about an organization's purpose include separating people into distinct departments, careful employee selection, and a strong leadership role.
- Companies in the United States can now incorporate with a legal structure that recognizes social and environmental missions as equally important to financial goals. This legal structure, called a benefit corporation, is now authorized in at least 21 states and the District of Columbia.

7.2 Corporate Social Responsibility

Even companies that do not incorporate as benefit organizations are paying greater attention to being socially responsible. The notion of **corporate social responsibility (CSR)** refers to management's efforts to make choices and take action so that the organization contributes to the welfare and interest of all organizational stakeholders, such as employees, customers, shareholders, the community, and the broader society.[22] There has been a worldwide explosion of corporate interest in CSR over the last decade. For example, MAS Holdings, a family-owned apparel manufacturer in Sri Lanka, has made a commitment to contribute to economic development while also improving the lives of employees, their families, and the community. In an era when clothing manufacturers are frequently in the news for another ethical, labor relations, or safety violation, MAS Holdings is making the news for its owners' belief that businesses have the power to make a positive difference in the lives of employees and the community. MAS, South Asia's largest manufacturer of lingerie, provides transportation to and from work, free meals, and medical care to all 45,000 employees in 28 plants. More than 90 percent of its workers are women, so MAS builds factories in rural areas with easy access so women can work close to their homes and families.[23]

CSR was once seen as the purview of small, offbeat companies like Patagonia or The Body Shop, but it has moved firmly into the mainstream of corporate thinking and behavior. IBM's Corporate Service Corps sends teams of volunteer employees on month-long assignments to work with projects such as reforming Kenya's postal system or designing an online education program in India. Campbell Soup gave

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a local food bank in Camden, New Jersey, access to its production lines to turn wilting food donations into jars of salsa that raised $100,000.[24] Whirlpool donates a refrigerator and range to every home built by Habitat for Humanity in North America. PepsiCo made a commitment to voluntarily remove high-calorie sweetened drinks from schools. More than 1,000 companies around the world have published reports proclaiming their concern for employees, the environment, and their local communities.[25]

Companies can now be assessed and measured on their performance along environmental, social, and governance (ESG) dimensions. Investors can invest in companies based on ESG performance. Elaborate checklists and scorecards are available for companies in most sectors and industries. ESG scores can range from 0 to 100 on items such as:

- Environment (e.g., water use, fuel management)
- Social capital (e.g., customer privacy, community development)
- Human capital (e.g., diversity opportunity, compensation and benefits)
- Business innovation (e.g., product societal value, quality and safety)
- Leadership and governance (e.g., business ethics, executive compensation)

One issue not often discussed in the light of corporate progress on ESG factors is the trade-off that exists between a firm's financial performance and its performance on ESG-type dimensions. Improving one may involve a cost to the other. Installing expensive solar energy equipment is good for the environment, for example, but it may be bad for the bottom line. This trade-off is similar to the need in hybrid enterprises to balance social and financial goals. Corporations, however, are legally chartered with profits as the primary goal, and their leaders may have to learn how to allocate resources away from contributing directly to profits in order to achieve ESG objectives.[26] In addition to the ESG framework, there are various approaches and models that businesses can adopt to facilitate and organize their socially responsible activities. These include the green movement, the triple bottom line, conscious capitalism, and stakeholder mapping.

ASSESS YOUR ANSWER

1 The best way for an organization to positively address a societal problem while at the same time succeeding as a business is to incorporate as a benefit corporation.

ANSWER: *Disagree.* Although incorporating as a benefit corporation allows the company to prioritize a social or environmental goal over financial benefit to shareholders without risk of lawsuits, this legal form is not yet available in every state. Organizations can positively contribute to society in many ways, such as by making a commitment to corporate social responsibility and measuring performance along environmental, social, and governance (ESG) dimensions.

7.2a The Green Movement

Most corporations are embracing an idea called *sustainability* or *sustainable development*. **Sustainability** refers to the ability to generate wealth without compromising social stewardship or responsibility for the environment. This means meeting the current and future needs of stakeholders while preserving the environment and

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society so that future generations can meet their needs as well.[27] With a philosophy of sustainability, managers weave environmental and social concerns into every strategic decision so that financial goals are achieved in a way that is socially and environmentally responsible.

When Jeff Immelt, former CEO of General Electric, first presented a plan for a "green" business initiative to 35 top GE executives in 2004, they voted it down. But Immelt, in a rare move, overruled them, and Ecomagination was born. Today, GE's Ecomagination is one of the world's most widely recognized corporate sustainability programs. It has not only cut GE's greenhouse gas emissions by more than 30 percent, but also added innovative products that are generating billions in annual revenue.[28]

Over the past 15 or so years since Immelt's decision, managers in many other organizations, from small, local companies to giant corporations, have also been going green to preserve the environment, spurred on by shifting social attitudes and the influence of social media and the Internet, which can quickly spread news of a corporation's negative impact on the environment. A survey found that 90 percent of Americans agree that there are important "green" issues and problems, and 82 percent think that businesses should implement environmentally friendly practices.[29] Since 2009, *Newsweek* has published a ranking that assesses the environmental performance of the 500 largest publicly traded companies in the United States and the 500 largest publicly traded global companies, which reflects the widespread interest in how companies are treating the environment. The top six companies on *Newsweek*'s 2018 U.S. Green list and Global list are shown below. These lists show the diversity of organizations embracing a green philosophy.[30]

United States	Global
Cisco Systems	L'Oreal SA (France)
Ecolab, Inc.	Centrica PLC (U.K.)
Hasbro, Inc.	Enbridge, Inc. (Canada)
PG&E Corp.	Siemens AG (Germany)
Sealed Air Corp.	Cisco Systems Inc. (U.S.)

7.2b The Triple Bottom Line

Managers in organizations that embrace sustainability measure their success in terms of a triple bottom line. The term **triple bottom line** refers to measuring an organization's social performance, its environmental performance, and its financial performance, as illustrated in Exhibit 7.3. This is sometimes called the three Ps: People, Planet, and Profit.[31]

The "People" part of the triple bottom line looks at how socially responsible the organization is in terms of fair labor practices, diversity, supplier relationships, treatment of employees, contributions to the community, and so forth. The "Planet" aspect measures the organization's commitment to environmental sustainability. The third P, of course, looks at the organization's profit, the financial bottom line. Based on the principle that what you measure is what you strive for and achieve, using a triple-bottom-line approach to measuring performance ensures that managers take social and environmental factors into account rather than blindly pursuing profit no matter the cost to society and the natural environment. One company emphasized the people dimension by giving everyone a raise.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Make a commitment to corporate social responsibility and sustainability. Assess performance along environmental, social, and governance dimensions. Apply the concept of the triple bottom line by measuring social performance, environmental performance, and financial performance.

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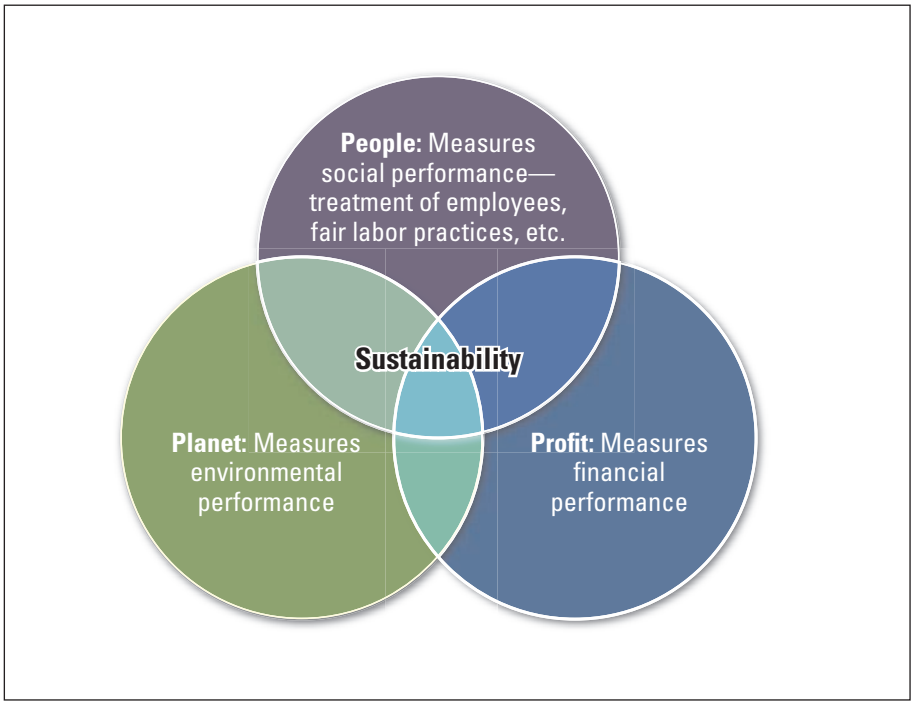
EXHIBIT 7.3
The Triple Bottom Line


People: Measures social performance—treatment of employees, fair labor practices, etc.
Sustainability
Planet: Measures environmental performance
Profit: Measures financial performance

IN PRACTICE
Gravity Payments

AP Images/Ted S. Warren

Gravity Payments went all out on the people dimension of the triple bottom line, raising everyone's salary to a minimum of $70,000. Gravity's 120 employees were stunned when Dan Price announced a few years ago that every employee at the Seattle-based credit-card processing company—even the lowest-paid clerk or assistant—would earn at least $70,000 a year. To cover part of the cost, Price cut his own $1.1 million compensation to the same level.

When asked why he did it, Price said in an interview that it was "so people who are giving their blood, sweat, and tears for our clients can live a normal life and pay their bills." Employees say he met that goal. They describe leading more comfortable, less stressful lives that allow them to better focus on their work. "I'm able to afford the small things that put my mind at ease," one employee who is a single mother said. "It really just cleared my mind."

Happier, more focused employees have helped Gravity grow. In 2018, the company processed $10.2 billion in credit card transactions, more than double the $3.8 billion in 2014, before the salary increase was announced. Gravity continues to add new clients, and profits are higher than ever. The company has grown to around 200 employees, some of whom joined because they wanted to be part of a company that doesn't just focus on profits. Tammi Kroll was climbing the corporate ladder and making $1 million annually when she heard about Gravity's pay increase. "My whole goal when I went to school was to make more money," said Kroll, who grew up in a working-class family. Yet, she said she came to realize, "Money doesn't make you happy, doesn't make you a better person." Even though it meant taking an 80 percent pay cut, Kroll, now Gravity's chief operating officer, says she was happy to move to a company that puts values first.[32]

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7.2c Conscious Capitalism

Conscious capitalism, which has also been referred to as a *shared value approach*, refers to organizational policies and practices that both enhance the economic success of a company and advance the economic and social conditions of the communities in which the company operates.[33] Hindustan Unilever, for example, uses a direct-to-home distribution system for its hygiene products in parts of India, whereby women from low-income households in villages of less than 2,000 people are given micro loans and training to start their own small businesses. The system benefits communities by giving women skills and opportunities that sometimes double their household income, as well as by reducing the spread of disease by bringing hygiene products into isolated areas. It also benefits the company by extending its market and building its brand in hard-to-reach areas. The project now accounts for five percent of Hindustan Unilever's revenue in India.[34]

Conscious capitalism means having a higher purpose besides just making money by focusing on employees, customers, suppliers, and the community as well as on shareholders; seeking to bring out the best in people; and fostering trust and respect. Companies that embrace a conscious capitalism philosophy include Whole Foods Market, Costco, Pedigree, Medtronic, and Trader Joe's. The BookMark further describes the philosophy of conscious capitalism.

BOOKMARK 7.0 HAVE YOU READ THIS BOOK?

Conscious Capitalism: Liberating the Heroic Spirit of Business

By John Mackey and Raj Sisodia

In *Conscious Capitalism*, John Mackey, founder and co-CEO of Whole Foods, and marketing professor Raj Sisodia start with the premise that business is "fundamentally good and ethical" because it enables people to live more vibrant and fulfilling lives. In just 200 years, they say, we have gone from 85 percent of the world's population living in extreme poverty to just 16 percent. But they challenge business leaders to open their eyes, minds, and hearts and understand the perspectives of their stakeholders so that "the truth, beauty, goodness, and heroism of free-enterprise capitalism" can be realized.

FOUR TENETS OF CONSCIOUS CAPITALISM

To practice conscious capitalism, business managers have to embrace the right beliefs. Here are the four tenets of conscious capitalism:

- *Have a higher purpose.* No business can practice conscious capitalism without a higher purpose. It is purpose that enables managers to transcend a narrow-minded focus on profit, infuse the organization with energy and relevance, and create engagement among employees and other stakeholders.
- *Recognize each stakeholder group as important and interdependent.* The authors refer to this as *stakeholder integration*. Conscious businesses strive to satisfy the needs of all stakeholders, including investors who seek profits. Trade-offs are not necessary, the authors say: "Together we can create our future reality, so we should do so consciously, collaboratively, and responsibly."
- *Conscious businesses need conscious leaders.* Leaders of conscious capitalism businesses embrace "decentralization, empowerment, innovation, and collaboration." Leaders are motivated by service to the higher purpose and the goal of aligning the interests of all stakeholders. The authors offer practical advice on how to evolve into a more conscious leader.
- *Embrace conscious business values.* The conscious capitalism culture embodies trust, accountability, fairness, love, transparency, integrity, caring, loyalty, personal growth, and egalitarianism.

IT *DOES* PAY TO DO GOOD

Money is one measure of value, but it is by no means the only measure. Mackey and Sisodia believe the primary business model will eventually be one of conscious capitalism rather than profit. They say hard data show that, in the long run, conscious businesses outperform traditionally run organizations by a wide margin.

Conscious Capitalism: Liberating the Heroic Spirit of Business, by John Mackey and Raj Sisodia, is published by Harvard Business Review Press.

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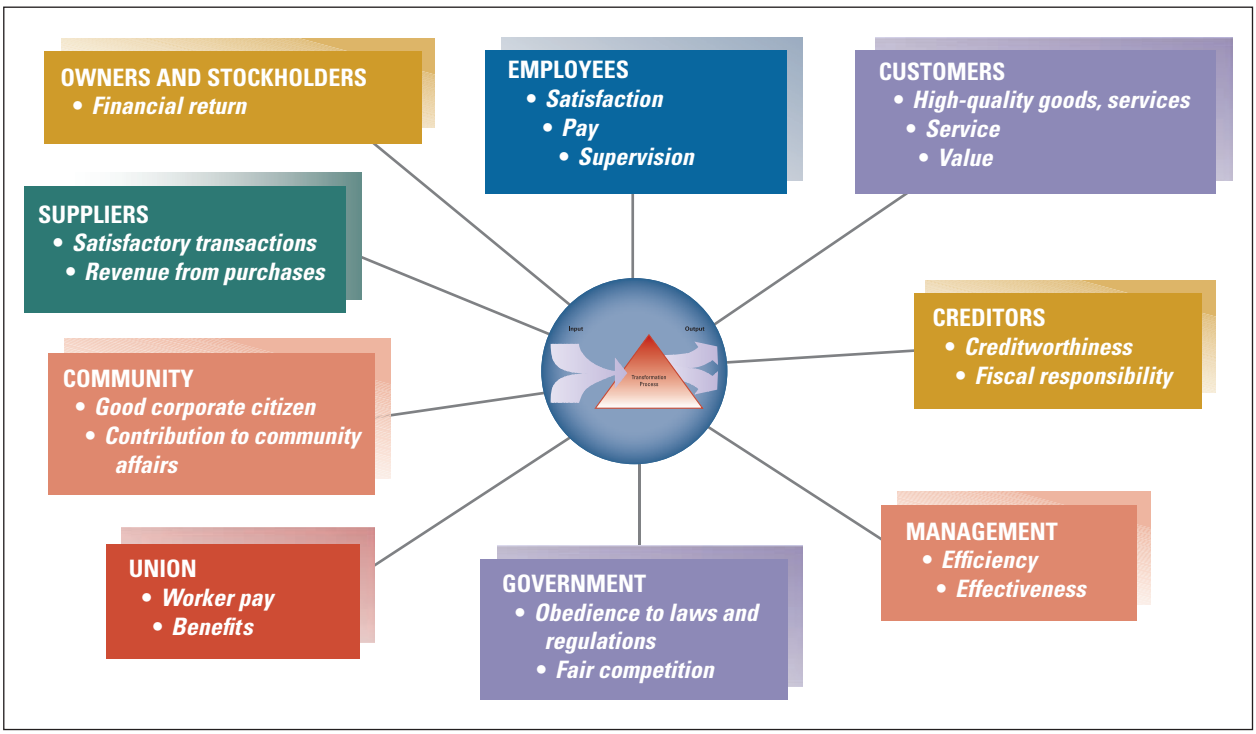
7.2d Serving Organizational Stakeholders

Another approach to expanding the concept of corporate performance beyond financial profits is to consider that different people and organizations want different things from the organization. For customers, the primary concern is high-quality products and services provided in a timely manner at a reasonable price, whereas employees are mostly concerned with adequate pay, good working conditions, and job satisfaction. Managers carefully balance the needs and interests of various *stakeholders* in setting goals and striving for effectiveness. This is referred to as the **stakeholder approach**, which integrates diverse organizational activities by looking at significant organizational stakeholders and what they want from the organization. A **stakeholder** is any group within or outside of the organization that has a stake in the organization's performance. The satisfaction level of each group can be assessed as an indication of the organization's overall performance and effectiveness.[35]

For example, in contrast to the view of government offices as bureaucratic quagmires of inefficiency run by lazy managers, the Hudson Street passport office in lower Manhattan gets glowing reviews on Google, Yelp, and other online rating sites. Michael Hoffman, director of the Hudson Street passport office, has a goal of giving customers exactly what they want. Even though he has to deal with some degree of specialization and standardization, he also has discretion in how he manages employees and runs the office. Hoffman has organized the office waiting and work areas in such a way that people and work flow smoothly. He also coaches and supports employees and gives them the resources and discretion to do their jobs without approval from managers when possible.[36]

Exhibit 7.4 illustrates various stakeholders and what each group wants from the organization. Most organizations are influenced by a similar variety of stakeholder groups.

EXHIBIT 7.4
Major Stakeholder Groups and What They Expect



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Investors and shareholders, employees, customers, and suppliers are considered primary stakeholders, without whom the organization cannot survive. Investors', shareholders', and suppliers' interests are served by managerial efficiency—that is, use of resources to achieve profits. Employees expect work satisfaction, pay, and good supervision. Customers are concerned with decisions about the quality, safety, and availability of goods and services. When any primary stakeholder group becomes seriously dissatisfied, the organization's viability is threatened.[37]

Other important stakeholders are the government and the community, which have become increasingly important in recent years. Corporations, for example, must operate within the limits of safety laws, environmental protection requirements, antitrust regulations, antibribery legislation, and other laws and regulations in the government sector. The community sector includes local governments, the natural environment, and the quality of life provided for residents. For many companies, trade unions and human rights organizations are highly important stakeholders. Special interest groups may include trade associations, political action committees, professional associations, and consumerists.

2 The most important stakeholders for any corporation that wants to succeed are its shareholders.

ASSESS YOUR ANSWER

ANSWER: *Disagree.* Although shareholders are important, organizations must respond to a variety of stakeholders. Investors and shareholders, employees, customers, and suppliers are considered primary stakeholders, without whom the organization cannot survive. However, other stakeholders such as government and the community have also become increasingly significant in recent years.

Stakeholder interests sometimes conflict, and organizations often find it difficult to simultaneously satisfy the demands of all groups. A business might have high customer satisfaction, but the organization might have difficulties with creditors or poor supplier relationships. Consider Walmart. Customers love its efficiency and low prices, but the low-cost emphasis has caused friction with suppliers. Some activist groups have argued that Walmart's tactics are unethical because they force suppliers to lay off workers, close factories, and outsource to manufacturers from low-wage countries. One supplier said clothing is being sold at Walmart so cheaply that many U.S. companies could not compete even if they paid their workers nothing. The challenges of managing such a huge organization have also led to strains in relationships with employees and other stakeholder groups, as evidenced by past gender discrimination suits and complaints about low wages and poor benefits.[38] More recently Walmart has raised wages and improved working conditions. The example of Walmart provides a glimpse of how difficult it can be for managers to satisfy multiple stakeholders. In all organizations, managers have to evaluate stakeholder concerns and establish goals that can achieve at least minimal satisfaction for major stakeholder groups.

There is growing interest in a technique called **stakeholder mapping**, which provides a systematic way to identify the expectations, needs, importance, and relative power of various stakeholders, which may change over time.[39] Stakeholder mapping helps managers identify or prioritize the key stakeholders related to a specific issue or project. For instance, when reports surfaced that a contractor in Lesotho, Africa that made clothing for Gap Inc. and other U.S. companies was dumping

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toxic materials into local landfills and discharging chemicals into the Caledon River, managers at Gap were able to swing into action immediately. By using stakeholder mapping, Gap had identified key stakeholders and carefully cultivated open relationships with labor groups, human rights organizations, trade unions, nongovernmental organizations, and other groups. In the past, managers' approach would have been to deny responsibility and blame the subcontractor. With the Lesotho incident, however, Gap's top leaders immediately stepped forward to declare the company's commitment to fair and safe conditions and outline the steps Gap would take in dealing with this contractor. Because of the relationships Gap had developed with numerous stakeholder groups, the company had the support of labor and human rights organizations, which praised managers' commitment and actions.[40]

The global supply chain is a source of ongoing challenges for managers. As Dan Rees, former director of the Ethical Trading Initiative (ETI) said, "It is not a crime to find child labor in your supply chain. What is important is what you do about it when you find out."[41] Many companies retract their orders and stop doing business with companies that are found to use unsafe or unethical practices. A more recent approach some are taking is to work closely with overseas factories to improve their conditions, which managers say benefits both sides of the equation.[42] By using stakeholder mapping and cultivating open, trust-based relationships with key stakeholders, companies such as Gap are trying to ensure that managers are able to do the right thing swiftly, sometimes with the result that crises can become opportunities.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Balance the needs and interests of the organization's various stakeholders, different people and groups who may want different things from the organization. Use stakeholder mapping when appropriate to identify and prioritize the key stakeholders related to a specific issue or project.

7.2e Serving the Bottom of the Pyramid

Another approach that combines business with social responsibility is referred to as *serving the bottom of the pyramid*. The **bottom of the pyramid (BOP)** concept proposes that large multinational corporations can alleviate poverty and other social ills, as well as make significant profits, by selling to the world's poorest people. The term *bottom of the pyramid* refers to the more than four billion people who make up the lowest level of the world's economic "pyramid," as defined by per-capita income.[43] Exhibit 7.5 illustrates the world's economic pyramid. The top of the pyramid (Tier 1) is composed of middle- and upper-income people in developed countries. The middle of the pyramid (Tiers 2 and 3) is made up of poor people in developed countries and the rising middle classes in lesser developed countries. Tier 4 contains the four billion people at the bottom of the pyramid. These people earn less than US$1,500 a year. Well over one billion people, roughly one-sixth of the human population, have per capita incomes of less than $1 a day.

EXHIBIT 7.5
The World Economic Pyramid

Annual Per Capita Income*	Tiers	Population in Millions
More Than $20,000	1	75–100
$15,000–$20,000	2 & 3	1,500–1,750
Less Than $1,500	4	4,000

* Based on purchasing power parity in U.S.$

Source: United Nations Development Reports, accessed at "Bottom of the Pyramid Report," Institute of Developing Economies Japan External Trade Organization, https://www.ide.go.jp/English/Data/Africa_file/Manualreport/bop03.html (accessed May 11, 2019).

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Traditionally, the world's poorest people haven't been served by most large businesses because products and services are too expensive, are inaccessible, and are not suited to their needs; therefore, in many countries, the poor end up paying significantly more than their wealthier counterparts for some basic needs. A number of leading companies are changing that by adopting BOP business models geared to serving the poorest of the world's consumers. Consider this example from India's Godrej & Boyce.

The India Today Group/Getty Images

IN PRACTICE
Godrej & Boyce

By one estimate, a third of India's food is lost to spoilage, but in 2007, refrigerator market penetration was just 18 percent. Godrej & Boyce managers decided it was time to do something about this. "As a company that made refrigerators for more than 50 years, we asked ourselves why it was that refrigerator penetration was just 18 percent," said G. Sunderraman, vice president of corporate development. The first major insight was that many people not only couldn't afford a refrigerator, but they didn't *need* a large refrigerator that took up too much space in a small house and used a lot of electricity. What they needed was the chotuKool ("The Little Cool"), an innovative appliance introduced by Godrej & Boyce in 2010. The chotuKool, a mini-fridge designed to cool five or six bottles of water and store a few pounds of food, was portable, ran on batteries, and sold for about 3,250 rupees (US$69), about 35 percent less than the cheapest refrigerator on the market.

To sell the new product, Godrej & Boyce trained rural villagers as salespeople. The villagers earn a commission of about US$3 for each refrigerator sold, and the system reduces Godrej's distribution costs. Godrej & Boyce managers spend a lot of time working directly with consumers and are now testing ideas for other low-cost products aimed at rural markets.[44]

Other companies are getting in on the BOP act too. For example, DSM Food Specialties, a Netherlands food-science company, developed a Nutrition Products of the World food program to reach 31 million people every year in Africa and the Middle East. Leapfrog Investments, based in the United Kingdom, launched a $135 million social-impact investment fund aimed at emerging markets in Asia and Africa. The fund invested in 17 companies that reached more than 111 million low-income people with financial and health services. The giant U.S. firm Johnson & Johnson collaborated with a nonprofit to set up a "mobile friend" free cell phone service in India that sends pregnant women and new moms voice messages with health updates and helpful information about raising children.[45] Procter & Gamble (P&G) researchers are visiting homes in China, Brazil, India, and other developing countries to see how the company can come up with entirely new products and services for consumers living at the bottom of the pyramid. However, P&G is late getting into marketing to the poor. Rival Unilever, for instance, introduced Lifebuoy soap to India more than a century ago, promoting it as the enemy of dirt and disease.[46] "P&G is still very U.S.-centric," says Unilever's CEO, Paul Polman, a Dutchman who is a P&G veteran. "Emerging markets are in the DNA of our company." Unilever, described previously in the section about conscious capitalism, gets about 58 percent of its sales from developing markets, up from just 20 percent in 1990.[47]

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Proponents of BOP thinking believe multinational firms can contribute to positive lasting change when the profit motive goes hand in hand with the desire to make a contribution to humankind. Companies can use their profit motivation to solve many societal problems by creating products that serve the poor and disadvantaged.

REMEMBER THIS

- Corporate social responsibility (CSR) refers to the obligation of organizational managers to make choices and take actions so that the organization contributes to the welfare and interest of all stakeholders, such as employees, customers, shareholders, the community, and the broader society.
- Managers can assess and measure the organization's performance on environmental, social, and governance (ESG) dimensions.
- Many companies are going green, embracing the concept of sustainability, which refers to the ability to generate wealth without compromising social stewardship or responsibility for the natural environment.
- Companies that place a high value on sustainability and CSR measure their success in terms of a triple bottom line—social performance, environmental performance, and financial performance.
- The term stakeholder refers to any group or person within or outside the organization that has some type of investment or interest in the organization's performance. Different stakeholders have different interests in the organization and thus different criteria for social responsiveness.
- Shareholders, employees, customers, and suppliers are considered primary stakeholders, without whom the organization could not survive.
- Managers sometime use stakeholder mapping to identify the expectations, needs, importance, and relative power of various stakeholders.
- Some large corporations take an approach called serving the bottom of the pyramid, combining business with social responsibility by creating products and services for the world's poorest people.
- Godrej & Boyce created an innovative battery-powered refrigerator called the chotuKool for rural markets in India.

7.3 The Consequences for Doing Good

The relationship of CSR to an organization's financial performance concerns both managers and organization scholars and has generated a lively debate.[48] Hundreds of studies have been undertaken to determine whether heightened social responsiveness increases or decreases a company's financial performance.[49] Studies have provided varying results, but they have generally found a positive relationship between socially responsible behavior and a firm's financial performance. For example, one study found that the top 100 global corporations that have made a commitment to sustainability had significantly higher sales growth, return on assets, profits, and cash flow from operations in at least some areas of the business.[50] Another review of the financial performance of large U.S. corporations considered "best corporate

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citizens" found that they enjoy both superior reputations and superior financial performance.[51] The Drucker Institute at Claremont Graduate University found that companies with higher social values generated higher stock values versus the broader S&P 500 over the previous month, year, three-year, and five-year periods. The Drucker Institute Corporate Effectiveness Index evaluates its stocks by weighting social scores twice as heavily as financial fundamentals. Social factors include customer satisfaction, employee engagement, and social responsibility. Company culture may be the most important contributor to the higher stock values, as other studies have shown that companies with more satisfied employees typically outperform the broader market.[52] Although results from these studies are not proof, they do provide an indication that using resources for social responsibility does not hurt companies.[53]

Companies are also making an effort to measure the nonfinancial factors that create value. Researchers find, for example, that people prefer to work for companies that demonstrate a high level of ethical behavior and social responsibility; thus, these organizations can attract and retain high-quality employees.[54] Sarah Antonette says she joined PNC Financial Services rather than two other companies that offered her a job because of PNC's strong employee volunteer program.[55] A vice president at Timberland says she has turned down lucrative offers from other companies because she prefers to work at a company that puts social responsibility ahead of just making a profit.[56] And a survey of 13- to 25-year-olds found that 79 percent say they want to work for a company that cares about how it affects or contributes to society.[57] Customers pay attention too. A study by Walker Research indicates that, price and quality being equal, two-thirds of customers say they would switch brands to do business with a company that is ethical and socially responsible.[58]

REMEMBER THIS

- Studies have generally found a positive relationship between socially responsible behavior and a firm's financial performance.
- The Drucker Institute found that companies with higher social values generated higher stock values versus the broader S&P 500 over the previous month, year, three-year, and five-year periods.
- Managers also consider nonfinancial factors that create value. Companies that demonstrate a commitment to social responsibility can attract and retain higher quality employees.
- Two-thirds of customers in one survey said they would switch brands to do business with a company that is ethical and socially responsible.

7.4 Designing a Structure for Executing a Sustainability Program

Successfully implementing a sustainability or CSR program depends heavily on three things: engaging employees, engaging outside stakeholders, and engaging a system of accountability that includes metrics and rewards.

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7.4a A Separate Department or Include Everyone?

Research evidence is clear that engaging all employees in a sustainability effort is a superior strategy over assigning responsibility to a separate department. As the chief marketing officer at Unilever expressed it, "Don't create a little department in the corner. Mainstream sustainability into all countries, all brands, all divisions." At Unilever, employees of the R&D and marketing departments work together to create and promote products that serve both business and society. One example is the introduction of a waterless soap, which saves lives by preventing the transmission of dangerous bacteria and saves water, a vital but limited resource in many communities Unilever serves. Because all employees make decisions with sustainability in mind, a new product was able to take root.[59]

To achieve a successful sustainability initiative, the organization's leaders must inspire employees and provide multiple avenues to help them incorporate sustainable thinking into their everyday work lives. This was certainly true for Ingersoll Rand's Green Teams, a global employee network that works internally and with outside partners such as community groups. From North Carolina to China, employees came together to agree on ideas such as riding bicycles to work instead of driving, and recycling and reusing materials versus creating unnecessary waste. Employee initiatives during one recent year saved an estimate 4.7 billion BTUs of energy.[60]

Making sustainability a part of every employee's job can have real payoff, because employees personally absorb sustainability thinking. One study found that morale was 55 percent better in companies that had strong sustainability programs, and employee loyalty was 38 percent stronger. Firms that adopted environmental standards have seen a 16 percent increase in productivity over firms that did not adopt sustainability practices. Other studies show that organizations with higher CSR performance can reduce employee turnover by 25 percent to 50 percent.[61]

Companies that are winning the sustainability battle have created the conditions for their employees to "own" sustainability. Psychological ownership refers to feelings of possession and connection that people develop toward an appealing object or idea. Feelings of ownership lead to greater job satisfaction, increased engagement, and higher productivity and profits. A sustainability program can be presented as an opportunity to contribute to the future well-being of both the company and society. Appealing to the heart—"We can make a difference to the world"—more than to the head can generate excitement about a higher purpose. An employee at a financial services company who attended a company sustainability workshop commented, "We're seeing how, through what we do in our day jobs, we can change lives."[62]

The best opportunities for improving the environmental impact of an organization come from the people who are closest to the day-to-day mechanics of existing operations. They are often the first to recognize and point out areas for improvement. The CEO of Kimberly-Clark explained where sustainability initiatives start: "Some of the best thinking on how to meet our goals has come from employees in our mills. We introduced a low-energy paper product in Italy to help retailers save shelf space and moms save room in their storage closet. Our Brazilian team saw how well it was working and adapted it for use in their country. It's been a huge success there."[63] Too often, however, the employees who are best positioned to influence sustainability do not understand how they can contribute. When employees understand their role and feel empowered, a company can achieve its sustainability goals. For example, Ingersoll Rand's Thermo King plant in Ireland became the first facility to commit to a zero waste to landfill program. The people on the front line of the plant played a crucial role by identifying waste streams and suggesting various approaches to either recycle or reuse those materials.[64]

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Some companies establish a separate sustainability department to handle administration details, but managers throughout the company are responsible for initiating and managing sustainability projects. A separate sustainability function can monitor progress and prepare reports for management and employees. For instance, one especially important activity a separate department can handle is preparing an annual report to let outside stakeholders and the public know how the company is progressing on its sustainability initiatives.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Engage all employees in sustainability and corporate social responsibility rather than sidelining these important initiatives into a separate department. Help people feel a sense of psychological ownership by appealing to their desires to contribute to a better organization and better society. Set clear, measurable goals for sustainability and reward people for helping to achieve them.

7.4b Involve External Stakeholders

Traditional business approaches have tried to create value for shareholders, often at the expense of other stakeholders. Collaborating with other businesses can be difficult; competitive self-interest, the lack of a shared purpose, and insufficient trust doom many efforts by companies to work together.[65] By contrast, sustainable businesses are redefining the corporate ecosystem to create value for all stakeholders, including employees, customers, shareholders, supply chains, communities, and the planet. For example, no single company can solve big social and environmental problems by going it alone. Industry collaborations are required to solve complex supply-chain issues such as deforestation, climate change and the depletion of scarce resources. A company serves itself and others well by collaborating with governments, social enterprises, NGOs and global companies. These collaborations often start with a small group of key organizations, overcoming self-interest to achieve shared interest to build and maintain trust.[66]

A company cannot assume that stakeholders will understand how its activities and innovations have improved sustainability performance if it has not communicated effectively. Many companies publish annual reports detailing goals and metrics for their ongoing sustainability projects. In addition, much of the value of sustainability comes from continually talking with key stakeholders. Through regular and repeated dialogue, a company with a sustainability agenda is better able to anticipate and react to economic, social, environmental, and regulatory changes. Poor relationships with stakeholders can lead to increased conflict and reduce stakeholder cooperation. In the gold mining industry, for example, stakeholder relationships with a company can heavily influence key factors such as land permitting, taxation, and the regulatory environment, thus playing a key role in a firm's success or failure.

Communication with stakeholders is as much about listening to stakeholder groups as it is about talking. Listening is a key mechanism for stakeholder engagement. The key is to establish a conversation that considers performance in a holistic manner (including sustainability), deals with hard trade-offs, builds a case for sharing ideas and innovations, and specifies the benefits generated. Communication is also central to obtaining feedback on how well the company is meeting stakeholder expectations and what it can do to improve the collaborative relationship.[67] For example, Natura, a Brazilian personal care products company, developed a virtual social network called Natura Conecta and invited the public to participate in discussions about corporate responsibility, sustainability, and people's expectations of the company. In the first year alone more than 8,000 people registered and contributed to the company's process of reporting to the public.[68]

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7.4c Set Goals, Measure, and Reward

The implementation of a sustainability program can appeal to the heads as well as the hearts of managers and employees. The head reflects rational decisions such as setting specific goals or targets, defining metrics to measure success, and providing rewards and incentives to people who achieve the goals. These three basic steps make up the planning and control cycle in most organizations.

Sustainability planning is more effective when it is part of the annual strategic planning process within an organization rather than done separately. Integrating sustainability or CSR planning into company-wide annual strategic planning increases its importance in the minds of managers and increases the likelihood of success. To manage implementation, leaders need to establish KPI (key performance indicator) metrics tied to important tangible goals, with clear assignment of responsibilities. Without measurable goals and accountability, sustainability efforts will founder.

Royal Dutch Shell became the first energy company to link executive pay raises to carbon emissions. Shell's specific targets will be more specific and shorter-term than previous measurements. Shell had been criticized by investors for setting excessively long-term goals, such as cutting carbon dioxide emissions in half by 2050. These ambitions lacked binding targets for shorter-term implementation. From 2020 onward Shell will set three-year or five-year targets every year and will link performance to executive pay. Competitors BP and Total have already set short-term targets on reducing carbon dioxide emissions.[69]

BHP Billiton, one of the largest mining companies in the world, understands the danger of environmental mismanagement. It has structured corporate-wide executive compensation to protect its license to produce major commodities such as aluminum, copper, iron, and coal. The company developed a balanced scoring system for its ESG (Environment, Social and Governance) metrics, which includes fatalities, environmental incidents, human rights impact, and environmental and occupational health. Fifteen percent of executive short-term incentives are now based on delivering on goals in these areas. Company leaders say linking rewards to ESG performance has had a significant impact. For example, energy consumption declined by 16 percent over six years and Billiton recorded its lowest injury rate in more than a decade.[70]

In 2016, the United Nations adopted 17 Sustainable Development Goals as a universal call to action to end poverty, protect the planet, and ensure that all people enjoy peace and prosperity. These 17 goals are listed in Exhibit 7.6. Goals 8, 9, 10, and 12 pertain to the economy; goals 1, 2, 3, 4, 5, 7, 11, and 16 pertain to society; and goals 6, 13, 14, and 15 pertain to the biosphere. Managers can link their organization's goals to the Sustainable Development Goals to ensure the company is effectively addressing sustainability issues. Today, for example, Ingersoll Rand is aligned with 11 of the 17 Sustainable Development Goals, including zero hunger, gender equality, clean water, portable and clean energy, sustainable cities and communities, and climate action. The company's network of global Green Teams took these goals to heart and made considerable strides by diverting 2.4 million pounds of waste from landfills and saving more than 2.2 million gallons of water. Moreover, in partnership with Thinkstep, a sustainability consulting firm, Ingersoll Rand developed a series of product greenhouse gas calculators to track product-related emissions, including emissions generated from electricity. Tracking metrics to show local and global improvement is an important step. Managers at Ingersoll Rand also recognize and reward employees who help achieve sustainability goals.

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EXHIBIT 7.6
United Nations Sustainable Development Goals

Goals	Description of Goals
1. No Poverty	End poverty in all forms everywhere
2. Zero Hunger	End hunger, achieve food security and improved nutrition and promote sustainable agriculture
3. Good Health and Well-being	Ensure healthy lives and promote well-being for all at all ages
4. Quality Education	Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all
5. Gender Equality	Achieve gender equality and empowerment for all women and girls
6. Clean Water and Sanitation	Ensure availability and sustainable management of water and sanitation for all
7. Affordable and Clean Energy	Ensure access to affordable, reliable, sustainable and modern energy for all
8. Decent Work and Economic Growth	Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all
9. Industry, Innovation and Infrastructure	Build reslilent infrastructure, promote inclusive and sustainable industrialization and foster innovation
10. Reduced Inequalities	Reduce inequality within and among countries
11. Sustainable Cities and Communities	Make cities and human settlements inclusive, safe, resilient and sustainable
12. Responsible Consumption and Production	Ensure sustainable consumption and production patterns
13. Climate Action	Take urgent action to combat climate change and its impact
14. Life Below Water	Conserve and sustainably use the oceans, seas and marine resources for sustainable development
15. Life on Land	Sustainably manage forests, combat desertification, and halt and reserve land degradation; halt biodiversity loss
16. Peace, Justice and Strong Institutions	Promote just, peaceful and inclusive societies
17. Partnership for Goals	Revitalize the global partnership for sustainable development

Whether through enterprise-wide recognition, team-based awards programs, or some other form, taking time to appreciate the dedication of team members goes a long way toward keeping people engaged and committed to sustainability initiatives.[71]

With the rationality and value of sustainability increasing weekly, the stakes are too great to leave them to chance or informal processes. Dow Chemical ensures that business managers include sustainability goals and plans in their annual planning process. In this way sustainability and business goals are better aligned because each business unit develops and owns both. GE formally reviews the environmental performance of all business units each year. Plant managers provide the recent data, and GE uses reviews to hold managers accountable for continuous improvement.[72]

Environmental management metrics can track and improve decision-making. At furniture maker Herman Miller, each designer can access a database that categorizes the environmental impact of various materials. This enables smart decision-making throughout the company. Linking environmental efforts with business metrics, such as cost savings or revenue growth, and reporting these metrics, can drive change toward better sustainability processes.[73]

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REMEMBER THIS

- For a successful sustainability or CSR program, managers should involve all employees rather than assigning responsibility to a separate department.
- One study found that morale was 55 percent better in companies that had strong sustainability programs, and employee loyalty was 38 percent stronger.
- The people on the front line of the organization often have the best ideas for improving the organization's impact on the environment.
- Sustainable businesses engage and communicate with all stakeholders, including employees, customers, shareholders, supply chains, and communities.
- Listening is a key part of communicating with stakeholders. Natura Conecta created a virtual social network and invited the public to participate in discussions about corporate responsibility and their expectations of the company.
- Sustainability planning should be incorporated into the organization's strategic planning process so top managers set clear goals and assign responsibility for sustainability efforts. Measuring results and rewarding people for achieving goals is equally important.

HOW DO YOU FIT THE DESIGN?

HOW SUSTAINABLE ARE YOU?

This exercise will help you better understand the role of personal sustainability behavior and what it means to you. To understand your sustainability, answer each of the following items as Mostly True or Mostly False.

		Mostly True	Mostly False
1.	I intentionally recycle and reduce waste as much as I can.	_____	_____
2.	I try to conserve water (e.g., limit shower time, turn off water while brushing teeth, wash only full loads of clothes).	_____	_____
3.	I do not drink from plastic water bottles.	_____	_____
4.	I would volunteer to work on a sustainability project at my campus or workplace.	_____	_____
5.	I believe that collective human actions are contributing to climate change.	_____	_____
6.	I would like to see more action in my community to protect the environment.	_____	_____
7.	I have participated in a sustainability project in the last five years.	_____	_____
8.	I consider myself an environmentalist.	_____	_____
9.	I am willing to change my lifestyle to reduce environmental damage.	_____	_____
10.	I would purchase a more expensive product if the packaging were more environmentally friendly.	_____	_____

Interpretation: Each of the preceding questions pertains to some aspect of your sustainability perspective. A higher score means a stronger interest in taking or supporting sustainability actions to preserve the environment. A higher score may also mean that your mental "logic" prefers social welfare over commercial life goals. A lower score means less interest in facilitating a sustainable environment, and it may mean that your mental "logic" tilts more toward commercial profit seeking. Compare your score with other students and discuss with them the extent to which each of you possesses a social welfare versus commercial logic.

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7.5 Designs to Uphold Ethical Values

In a survey by the Ethics Resource Center, 41 percent of the 6,400 U.S. employees surveyed say they have observed wrongdoing at work. That sounds high, but it is a decrease from 45 percent in 2011 and 55 percent in 2007. The bad news, though, is that 60 percent of the ethical violations were by someone with managerial authority. In addition, the percentage of employees who say they were retaliated against for reporting ethical wrongdoing remains about the same as in the earlier surveys.[74] And the problem isn't limited to U.S. corporations. Business leaders in countries such as Germany and Japan have also been reeling in recent years from one headline-grabbing scandal after another.[75] Volkswagen is still recovering from the scandal that erupted when the company was found to have used software in diesel vehicles designed to cheat U.S. emissions tests. Japan-based Kobe Steel recently admitted that the company had been cutting corners and falsifying quality specifications on products for decades. In early 2018, CEO Hiroya Kawasaki resigned to take responsibility for the deceit, and the company installed a new top leadership team to try to fix the mess.[76] Top corporate managers are under scrutiny from the public as never before, and even small companies are finding a need to put more emphasis on ethics to restore trust among their customers and the community.

7.5a Sources of Individual Ethical Principles

Ethics refers to the code of moral principles and values that governs the behaviors of a person or group with respect to what is right or wrong. Ethical values set standards as to what is good or bad in conduct and decision making.[77] Ethics are personal and unique to each individual, although in any given group, organization, or society, there are many areas of consensus about what constitutes ethical behavior.[78] Each person is a creation of his or her time and place in history. National culture, religious heritage, historical background, and so forth lead to the development of societal morality, or society's view of what is right and wrong. Societal morality is often reflected in norms of behavior and values about what makes sense for an orderly society. Some principles are codified into laws and regulations, such as laws against drunk driving, robbery, or murder.

These laws, as well as unwritten societal norms and values, shape the local environment within which each individual acts, such as a person's community, family, and place of work. Individuals absorb the beliefs and values of their family, community, culture, society, religious community, and geographic environment, typically discarding some and incorporating others into their own personal ethical standards. Each person's ethical stance is thus a blending of his or her historical, cultural, societal, and family backgrounds and influences.

It is important to look at individual ethics because ethical behavior always involves an individual action, whether it is a decision to act or the failure to take action against wrongdoing by others. In organizations, an individual's ethical stance may be affected by peers, subordinates, and supervisors, as well as by the organizational culture. Organizational culture often has a profound influence on individual choices and can support and encourage ethical actions or promote unethical and socially irresponsible behavior.

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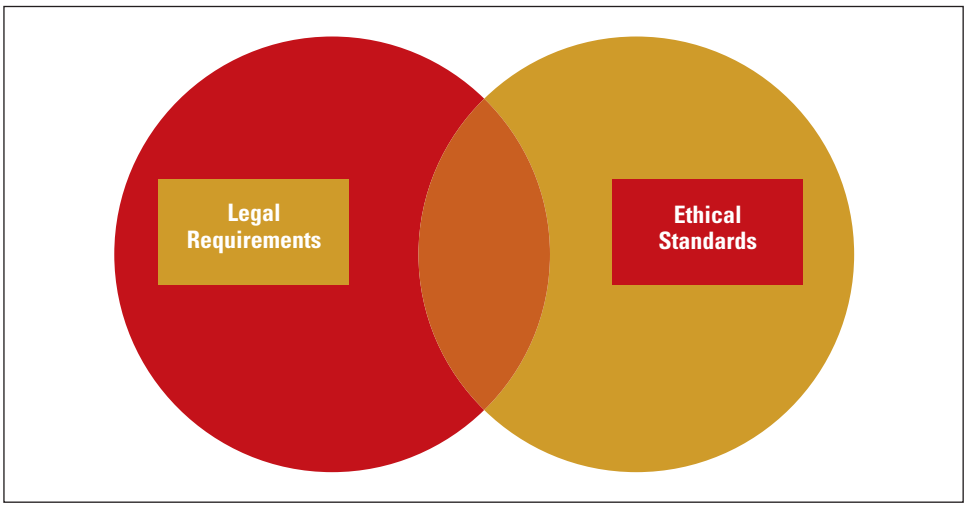
7.5b Organizational Ethics

Many of the recent scandals in the news have dealt with people and corporations that violated regulations or broke the law. For example, Facebook and Google have gotten into trouble internationally for insufficient protection of user privacy. A coalition of children's advocacy, health, and public interest groups filed complaints with the Federal Trade Commission alleging that online marketing by McDonald's HappyMeal.com, SubwayKids.com, and several other online sites violates a federal law protecting children's privacy. Since it is illegal to collect e-mail addresses and send marketing materials directly to children, critics say, these and other companies use tactics such as getting website users to play games and share them with friends, so the site can then target those friends with marketing messages.[79] Many companies have been accused of paying bribes in foreign countries, which is a violation of U.S. law.[80] But it is important to remember that ethical decisions go far beyond behaviors governed by law.[81] The **rule of law** arises from a set of codified principles and regulations that describe how people are required to act, that are generally accepted in society, and that are enforceable in the courts.[82]

For example, federal prosecutors have charged 50 people, including high-profile actresses Felicity Huffman and Lori Loughlin, in a widespread college admissions scam in which parents allegedly paid bribes to have test scores upgraded or sports participation falsified in order to get their children accepted at top colleges and universities. The ringleader of the scam, consultant William Singer, pled guilty to racketeering conspiracy, money laundering conspiracy, conspiracy to defraud the United States, and other charges, and some of the parents and others involved have also been negotiating guilty pleas.[83] This is a clear incidence of breaking the law, but allegations of cheating among navy instructors at the military's nuclear-reactor training center in Charleston, South Carolina were not as clear-cut. After an investigation, Navy officials discharged at least 34 senior enlisted sailors for the cheating. Although no laws were broken, Admiral Jonathan Greenert of the U.S. Navy said, "This is contrary to our core values. The foundation of our conduct throughout the Navy is integrity."[84]

The relationship between ethical standards and legal requirements is illustrated in Exhibit 7.7. Ethical standards for the most part apply to behavior not covered by the law, and the rule of law applies to behaviors not necessarily covered by ethical

EXHIBIT 7.7
Relationship Between the Rule of Law and Ethical Standards



Source: LaRue Tone Hosmer, *The Ethics of Management*, 2nd ed. (Homewood, IL: Irwin, 1991).

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standards. Current laws often reflect combined moral judgments, but not all moral judgments are codified into law. The morality of aiding a drowning person, for example, is not specified by law, and driving on the right-hand side of the road has no moral basis; but in acts such as robbery or murder, rules and moral standards overlap. Many people believe that if you are not breaking the law, then you are behaving in an ethical manner, but this is not always true. Many behaviors have not been codified, and managers must be sensitive to emerging norms and values about those issues.

Organizational ethics are principles that guide the decisions and behaviors of managers with regard to whether they are right or wrong. The following examples illustrate the need for managerial ethics:[85]

- Top executives are considering promoting a rising sales manager who consistently brings in $70 million a year and has cracked open new markets in places like Brazil and Russia that are important for international growth. However, female employees have been complaining for years that the manager is verbally abusive to them, tells offensive jokes, and throws temper tantrums if female employees don't do exactly as he says.
- The manager of a beauty supply store is told that she and her salespeople can receive large bonuses for selling a specified number of boxes of a new product, a permanent-wave solution that costs nearly twice as much as what most of her salon customers typically use. She orders her salespeople to store the old product in the back and tell customers there's been a delay in delivery.
- A North American manufacturer operating abroad was asked to make cash payments (a bribe) to government officials and was told by local business partners that it was consistent with local customs, despite being illegal in North America.

As these examples illustrate, being ethical is about making decisions. Managers make choices every day about whether to be honest or deceitful with customers and suppliers, treat employees with respect or disdain, and be a good or a harmful corporate citizen. Some issues are exceedingly difficult to resolve and often represent ethical dilemmas. An **ethical dilemma** arises in a situation concerning right and wrong in which values are in conflict.[86] Right or wrong cannot be clearly identified in such situations. For a salesperson at the beauty supply store, for example, the value conflict is between being honest with customers and adhering to the boss's expectations. The manufacturing manager may feel torn between respecting and following local customs in a foreign country or adhering to U.S. laws concerning bribes. Sometimes, each alternative choice or behavior seems undesirable. Ethical dilemmas are not easy to resolve, but top executives can aid the process by establishing organizational values that give people guidelines for making the best decision from a moral standpoint.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Take control of ethical values in the organization. Recognize that ethics is not the same as following the law, and help people learn how to make ethical decisions. Adhere to a strong code of ethics and support people who report wrongdoing.

7.5c Formal Structure and Systems

Another set of tools managers can use to shape ethical values is the formal structure and systems of the organization. These systems can be especially effective for influencing managerial ethics. Exhibit 7.8 lists some of the ways managers create and support an ethical organization.

Structure. Most experts agree that a formal ethics program is necessary to ensure an ethical culture, especially for large organizations.[87] This not only allocates

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EXHIBIT 7.8
Structures and Systems for Building an Ethical Organization

organization time and energy to the problem but symbolizes to everyone the importance of ethics. Top executives can assign responsibility for ethical values to a specific position. One example is an **ethics committee**, which is a cross-functional group of executives who oversee company ethics. The committee provides rulings on questionable ethical issues and assumes responsibility for disciplining wrongdoers. By appointing top-level executives to serve on the committee, the organization signals the importance of ethics.

Today, many organizations are setting up ethics departments that manage and coordinate all corporate ethics activities. These departments are headed by a chief ethics or **compliance officer**, a high-level company executive who oversees all aspects of ethics, including establishing and broadly communicating ethical standards, setting up ethics training programs, supervising the investigation of ethical problems, and advising managers on the ethical aspects of corporate decisions. For this to be an effective position, the compliance officer should have direct access to the company's board and not be subject to being fired by the CEO.[88]

Ethics offices sometimes also work as counseling centers to help employees resolve tricky ethical dilemmas. The focus is as much on helping employees make the right decisions as on disciplining wrongdoers. Most ethics offices have confidential **ethics hotlines** that employees can use to seek guidance as well as report questionable behavior. One organization calls its hotline a "Guide Line" to emphasize its use as a tool for making ethical decisions as well as reporting lapses.[89] According to Gary Edwards, president of the Ethics Resource Center, between 65 and 85 percent of calls to hotlines in the organizations he advises are calls for counsel on ethical issues.[90]

Disclosure Mechanisms. A confidential hotline is also an important mechanism for employees to voice concerns about ethical practices. Holding organizations accountable depends to some degree on individuals who are willing to speak up if they suspect illegal, dangerous, or unethical activities. **Whistle-blowing** involves employee disclosure of illegal, immoral, or illegitimate practices on the part of the organization.[91] As ethical problems in the corporate world increase, many companies are looking for ways to protect whistle-blowers. In addition, calls are increasing for stronger legal protection for those who report illegal or unethical business activities.[92] When there are no protective measures, whistle-blowers suffer, and the company may continue its unethical or illegal practices. A whistle-blower bounty program, created as part of the Dodd-Frank finance regulatory overhaul law, is designed to reward whistle-blowers and prevent what happened to Matthew Lee, a former senior vice president in Lehman Brothers' accounting division. Lee lost his job just weeks after he raised concerns about how the firm was hiding risks by temporarily "parking" $50 billion in risky loan assets off its balance sheet. Lawrence McDonald, a former Lehman trader who has written a book about the giant firm's collapse, says Lehman routinely sacked or ostracized whistle-blowers, which allowed the company to continue its risky and unethical behavior.[93] Unlike Lee, a whistle-blower who helped stop a multimillion-dollar fraud at another company was given $50,000 in August 2012, a percentage of the amount collected in the case.[94]

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Many governments, including the United States and Japan, have passed laws aimed at protecting whistle-blowers, but that isn't enough. Enlightened managers strive to create an organizational climate and culture in which people feel free to point out problems and managers take swift action to address concerns about unethical or illegal activities. Organizations can view whistle-blowing as a benefit to the company, helping prevent the kind of disasters that hit companies such as Enron, Bear Stearns, Countrywide, News Corporation, and Lehman Brothers during the financial crisis of 2008.

3 The single best way to make sure an organization stays on solid ethical ground is to have a strong code of ethics and make sure all employees are familiar with its guidelines.

ASSESS YOUR ANSWER

ANSWER: *Disagree.* Having a strong code of ethics can be an important part of creating an ethical organization, but managers' actions are more powerful in determining whether people live up to high ethical standards. If managers and top leaders are dishonest, unprincipled, or ruthless and create a culture that supports or ignores these behaviors in others, employees will put little stock in the formal ethics code.

Code of Ethics. At a minimum, every company needs a code of ethics that is easy to understand, includes examples, and explains expected behaviors and sanctions.[95] A **code of ethics** is a formal statement of the company's values concerning ethics and social responsibility; it clarifies to employees what the company stands for and its expectations for employee conduct. The code of ethics at Lockheed Martin, for example, states that the organization "aims to set the standard for ethical conduct" through adhering to the values of honesty, integrity, respect, trust, responsibility, and citizenship. The code specifies the types of behaviors expected to honor these values and encourages employees to use available company resources to help make ethical choices and decisions.[96] Codes of ethics may cover a broad range of issues, including statements of the company's guiding values; guidelines related to issues such as workplace safety, the security of proprietary information, or employee privacy; and commitments to environmental responsibility, product safety, and other matters of concern to stakeholders. Swiss bank UBS AG, for example, developed a strong code of ethics addressing issues such as financial crime, competition, and confidentiality, including outlining sanctions against employees who violate the code. The code explicitly bans staff from helping clients cheat on their taxes, in response to a damaging investigation into the use of hidden offshore accounts. The Internal Revenue Service gave the largest-ever whistle-blower award—$104 million—to a former UBS banker who helped expose the fraud.[97] In an important step, the new code prohibits retaliation by managers against employees who report misconduct.[98]

General statements of principle are often called *corporate credos*. One good example is Johnson & Johnson's "The Credo." Available in 36 languages, The Credo has guided Johnson & Johnson's managers for more than 60 years in making decisions that honor the company's responsibilities to employees, customers, the community, and stockholders. Another example is Google's *Code of Conduct*. Portions of the Google Code are shown in the following In Practice.

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IN PRACTICE
Google

Google is one of the best-known companies in the world, and managers take seriously its reputation for both technological superiority and a commitment to ethics and social responsibility. Google's Code of Conduct starts with these words: "Don't be evil. Googlers generally apply those words to how we serve our users. But 'Don't be evil' is much more than that."

Google uses a well-designed Code of Conduct to put the motto into practice. The code is divided into seven sections, with each subdivided into sections that describe specific values, policies, and expectations. The Code also clearly states that employees will be protected if they call attention to ethical violations or misconduct. Here are some excerpts from Google's Code:

Serve Our Users
Our users value Google not only because we deliver great products and services, but because we hold ourselves to a higher standard in how we treat users and operate more generally.

Respect Each Other
We are committed to a supportive work environment, where employees have the opportunity to reach their fullest potential. Each Googler is expected to do his or her utmost to create a respectful workplace culture that is free of harassment, intimidation, bias and unlawful discrimination of any kind.

Preserve Confidentiality
We get a lot of press attention around our innovations and our culture, and that's usually fine. However, company information that leaks prematurely into the press or to competitors can hurt our product launches, eliminate our competitive advantage and prove costly in other ways.

Ensure Financial Integrity and Responsibility
Financial integrity and fiscal responsibility are core aspects of corporate professionalism. . . The money we spend on behalf of Google is not ours; it's the company's and, ultimately, our shareholders'.

Obey the Law
Google takes its responsibilities to comply with laws and regulations very seriously and each of us is expected to comply with applicable legal requirements and prohibitions.

Conclusion
Google aspires to be a different kind of company. It's impossible to spell out every possible ethical scenario we might face. Instead, we rely on one another's good judgment to uphold a high standard of integrity for ourselves and our company.

And remember . . . don't be evil, and if you see something that you think isn't right—speak up![99]

Some companies use broader values statements within which ethics is a part. These statements define ethical values as well as corporate culture and contain language about company responsibility, quality of products, and treatment of employees. A formal statement of values can serve as a fundamental organizational document that defines what the organization stands for and clarifies the expected ethical behaviors and choices.[100]

Although written codes of ethics and value statements are important, it is essential that top managers support and reinforce the codes through their actions, including rewards for compliance and discipline for violations. Otherwise, a code of ethics is nothing more than a piece of paper. Indeed, one study found that companies with a written code of ethics are just as likely as those without a code to be found guilty of illegal activities.[101]

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REMEMBER THIS

- An individual's ethical stance is a blending of his or her historical, cultural, societal, and family backgrounds and influences.
- Ethical issues can sometimes be very complex. An ethical dilemma is a situation in which values are in conflict and right and wrong cannot be clearly identified.
- Organizational managers can support and encourage ethical behaviors through their actions and through formal structures and systems, such as an ethics committee, a chief ethics or compliance officer, and ethics hotlines.
- At a minimum, every company needs a code of ethics that clarifies for employees the ethical values the company stands for and its expectations for employee behavior.
- To have an ethical organization, managers must support whistle-blowing, which refers to employee disclosure of illegal, dangerous, or unethical activities in the organization.

7.6 Corporate Ethics in a Global Environment

Organizations operating on a global basis often face particularly tough ethical challenges because of the various cultural and market factors they deal with. The greater complexity of the environment and organizational domain creates a greater potential for ethical problems or misunderstandings.[102]

The global supply chain is a source of ongoing challenges for managers, for example. The global supply chain is so broad and diffuse that managers often have a hard time even knowing what firms they are doing business with, much less what is going on in all those different contractors and subcontractors. Amazon has distribution centers in Germany and, because of high costs in that country, it often works with third parties to hire and manage thousands of temporary immigrant workers from Poland, Spain, Romania, and other European countries, allowing Amazon to adjust to seasonal needs. The company became embroiled in an ethical quagmire after German public television aired a documentary in which workers said security guards from HESS (short for Hensel European Security Services) intimidate them, search them for pilfered food, and spot-check their cramped living quarters unannounced. The program showed some guards wearing clothing from Thor Steinar, a German fashion label popular with the country's neo-Nazi community. Amazon immediately stopped doing business with HESS, whose executives denied the allegations and said, "We explicitly distance ourselves from any form of political radicalism."[103]

Another concern when doing business globally is that employees from different countries may have varied attitudes and beliefs that make it difficult to establish a sense of community and cohesiveness based on the ethical culture. In fact, research has indicated that national culture has a greater impact on employees than does corporate culture, and differences in national culture also create tremendous variance in ethical attitudes.[104] Managers often struggle to translate the ideas for developing strong, ethical corporate cultures to a complex global environment. Accenture, a management consulting, technology services, and outsourcing company with

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140,000 employees in 48 countries, worked with liaisons in each region, called "Geographic Ethics Leads," to make sure the ethics code was written in appropriate language and addressed the needs of employees in the different regions. These liaisons received input from employees at focus group sessions held in each country. Thus, although there are core ethical values in common, the company's code of ethics is customized for each country where Accenture has offices.[105]

REMEMBER THIS

- Organizations that operate globally face particularly tough ethical challenges because of the various cultural and market factors they deal with.
- The global supply chain is one source of ongoing ethical challenges for managers.
- Managers may struggle to translate the ideas for developing strong, ethical corporate cultures to a complex global environment because employees from different countries have varied attitudes and beliefs.

KEY CONCEPTS

benefit corporation
bottom of the pyramid (BOP)
code of ethics
compliance officer
conscious capitalism
corporate social responsibility (CSR)
ethical dilemma
ethics
ethics committee
ethics hotline
hybrid organization
logic
mission drift
organizational ethics
rule of law
stakeholder
stakeholder approach
stakeholder mapping
sustainability
triple bottom line
whistle-blowing

DISCUSSION QUESTIONS

1. What is a hybrid organization? How does it differ from a typical nonprofit or profit-seeking organization?
2. Compare and contrast the two major "logics" that organization members might hold in a hybrid organization.
3. How might "mission drift" hurt the performance of a social enterprise?
4. Do you personally embrace a commercial logic or a social welfare logic? Why do you think you hold to that perspective?
5. Why would a social enterprise be better able to maintain a strong social welfare purpose by choosing other like-minded organizations with which to collaborate?
6. What do you think would happen if a hybrid organization focused on profit goals to the exclusion of social goals? If vice-versa? Explain.
7. Is it reasonable to expect that managers can measure their social and environmental performance with the same accuracy as they measure financial outcomes when using a triple bottom line approach?
8. A survey found that 69 percent of MBA students view maximizing shareholder value as the primary responsibility of a company. How would that philosophy fit into a hybrid organization?
9. There is research evidence to suggest that employees are happier working for a company that provides them with opportunities to contribute to environmental sustainability. Why do you think this would be the case?
10. Explain the concept of conscious capitalism. Do you think managers and companies that espouse this kind of shared value approach are more likely to behave in socially responsible ways?

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CHAPTER 7 WORKSHOP What is Your Level of Ethical Maturity?

This exercise will help you better understand the concept of ethics and what it means to you. It probably will not happen right away, but soon enough in your duties as an organization manager, you will be confronted with a situation that will test the strength of your ethical beliefs or your sense of justice. When answering the questions below, think about times when you were part of a student or work group. To what extent does each of the following statements characterize your behavior when working with others in a group?

Spend a few minutes individually answering the questions below.

	Mostly True	Mostly False
1. I can clearly state the principles and values that guide my actions.	_____	_____
2. I quickly acknowledge my mistakes and take responsibility for them.	_____	_____
3. I am able to quickly "forgive and forget" when someone has made a serious mistake that affected me.	_____	_____
4. When making a difficult decision, I take time to assess my principles and values.	_____	_____
5. I have a reputation among my friends and coworkers for keeping my word.	_____	_____
6. I am completely honest and can be trusted to tell the truth.	_____	_____
7. When someone asks me to keep a confidence, I always do so completely.	_____	_____
8. I hold others accountable for using ethical practices in their work.	_____	_____
9. I insist on doing what is fair and ethical even when it is not easy.	_____	_____
10. My coworkers would say that my behavior is very consistent with my values.	_____	_____

Scoring: Count the number of Mostly True answers. Then follow the instructions below

a. Divide into teams of four members.
b. Each member report the number of Mostly True answers, and what your score means to you.
c. Again, in turn, each member describe what they think influences their ethical behavior and decisions, such as a need for success or approval.
d. Have groups share the common themes among their answers with the whole class, after which the instructor may lead a discussion on ethics and its power in organizations.

Interpretation: Each of the questions above pertains to some aspect of ethical maturity. Ethical maturity means that you have the moral awareness to recognize the ethical elements of a given situation. In addition, it means the ability not only to judge right from wrong but the autonomy to make the ethical choice under difficult circumstances. Study the specific questions for which you scored Mostly True or Mostly False to learn more about your specific strengths and weaknesses. Think about what influences your ethical behavior and decisions, such as the need for success or approval.

CASE FOR ANALYSIS | Solo: Helping a Million People See Again[106]

Jenny Amaraneni is a social entrepreneur determined to build a social enterprise named SOLO Eyewear. Solo produces a line of hand-crafted sunglasses made from bamboo materials, with a portion of the funds from each pair sold donated to providing eye care for poverty-stricken people in need of prescription eyeglasses and sight-saving eye surgeries.

While in college, Amaraneni was inspired to develop a company that both generated profit and positively affected people. She discovered there was a great need for eye care around the world and decided to research the issue further. Amaraneni, who has poor vision herself, found that approximately one billion people do not have access to eye care and nearly 80 percent of the world's blindness is preventable. The poor state of eye care in the world consumed her. She set a goal: help at least one million people see again.

Amaraneni did extensive research and found that corporations that embrace the triple bottom line concept have a higher level of financial performance. With the current American consumer environment leaning toward sustainability (green products) she saw the unlimited

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possibilities for a triple bottom line company with a mission of eye care for the poor.

Amaraneni soon discovered that the process of starting a company was incredibly difficult. She realized that her commitment to help others had to be funded by creating a serious business that could compete in a global economy. She had to develop a valuable product that consumers would buy to finance both the people and planet aspects of her vision. After much research, Amaraneni chose to develop a unique product that included bamboo wood. Bamboo can be difficult to work with, and she identified a contract manufacturing company to develop the eyewear product. The use of bamboo required the bonding of two different materials—bamboo and recycled plastic—during manufacturing. She ordered the first run of 1,000 units. After about 500 units were sold, she learned there was a massive quality problem. The sunglasses were coming apart where the bamboo connected to the recycled plastic. Customers were complaining. Amaraneni was rocked and embarrassed by the news because the fiasco could ruin the brand and undermine her mission. She decided to stop sales immediately.

Amaraneni e-mailed all customers immediately to inform them about the manufacturing problem. This was a very risky decision because it would call attention to the product defect. However, she felt "it was the right thing to do." She guaranteed all customers that they would receive replacement eyewear or their money back. For weeks, Amaraneni and her staff e-mailed and updated customers by social media almost every day about progress. In addition, she used revenue generated from sales to fund eye surgeries in India, and SOLO communicated those successes as well. Amaraneni's transparency had impact. Her communications opened a dialogue between the company and its customers. By offering customers immediate replacement or their money back she reinforced the principles of a triple bottom line company. Customers were given the option to either wait six weeks for a replacement product or receive an immediate refund. Amazingly, out of 1,000 orders, only five customers asked for their money back. SOLO Eyewear customers clearly had bought in to the mission of the company for helping less fortunate people.

Amaraneni realized SOLO Eyewear should continue open and honest communication with her community. Her way of handling things brought SOLO positive media exposure. When the news of the first surgeries in India came to the United States, it generated attention both online and in the traditional news media. More interviews followed. By engaging its stakeholders, SOLO Eyewear assured them that producing a high-quality, environmentally friendly product and helping others could be achieved simultaneously. Public awareness of this new company became more about helping others and less about product problems.

Amaraneni learned she did not have sufficient expertise to select a manufacturing supplier. She used her aggressive networking talent to find individuals with expertise about manufacturer selection. The experts persuaded her that more money should be spent on product design and manufacturing, resulting in a tripling of the retail price of the product. This was an astounding increase. The new price point allowed her to choose a premium manufacturer to produce a top-quality product. If successful, the higher prices would generate more revenue and profit to help even more people in need.

Amaraneni became an evangelist for her company and she began seeding other evangelists. She repeated her vision to everyone she interacted with, including the news media. The story was compelling and carried a strong emotional component. "We are creating a company that will ultimately restore eyesight to over one million people," Amaraneni pointed out. This company vision, along with Amaraneni's transparent communication about what was going on within the company created a loyal following. The company attracted more than 15 interns who volunteered to work 10-12 hours. The interns volunteer their time because of their dedication to SOLO's mission. SOLO was generating tremendous word-of-mouth, which was important because only 14 percent of people believe what they see, read, or hear, whereas 90 percent believe endorsements from friends and acquaintances.

SOLO Eyewear continues to grow. Expenses are kept to a minimum by housing the corporate office in Amaraneni's condo. Marketing is done inexpensively by using cloud-based tools such as social media, Skype, and social meetings, along with marketing events. Today, SOLO Eyewear has had online sales in 29 countries and has improved the eyesight of more than 10,000 people in 19 countries through new eyeglasses or cataract surgery. Thousands of people have purchased the company's products and have become evangelists for SOLO, living up to its tag line "Together we can change lives."

Questions

1. Why do you think there are no noticeable conflicts between the social welfare logic and the commercial logic at SOLO?
2. Which aspect of Amaraneni's behavior do you think was most important for getting SOLO off the ground? Why?
3. Do you think Amaraneni's start-up company would have succeeded had it not had a triple bottom line mission? Explain.

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CASE FOR ANALYSIS | Fiedler, Philips & Wilson Design

Sitting in Maisson's Restaurant, Janelle Mosley completely lost interest in her chef salad and now sat sipping her Pinot Grigio and watching with a combination of amusement and curiosity her rival, Jonathan Draper, "doing his own thing." Seated across the room and oblivious to everyone and everything around him, including a lunch that had been shoved aside, he feverishly shuffled papers, typed into a tablet, and talked into his cell phone.

What's he up to? she wondered, ignoring the impulse to move to a seat near him and skulk around, listening to the call from behind the potted plant. *Too 'cloak and dagger'* she chuckled.

Both of them had landed coveted internships with major architectural firms—he, with prestigious Grace and Creswell, and she with #2 Fiedler, Philips & Wilson. The two firms were locked in competition for the city's new symphony center. Jonathan was considered by many to be the most brilliant and innovative student in the university's 20-year-old school of architecture. But his glaring eccentricities—particularly his tendency to shuffle and carry reams of file folders with tiny notes and sheets of paper cascading around him—had both amused and frustrated others and had earned him the nickname, "Dropsy Draper." Still, even with all the dropping, he managed to dazzle with his plans and designs.

Now, after paying her check at the table, Janelle watched as Dropsy grabbed his materials and hurried out the door. Exiting the building, she saw him parked curbside, fumbling with keys and armloads of files as he yelled into the phone nestled tightly between cheek and shoulder.

As he screeched away, one file remained curbside. Janelle ran to retrieve it, but upon opening it, she discovered these were his own carefully written project notes for Grace & Creswell's symphony project.

She slammed it shut. *Oh, God! What did he just lose?*

Racing back to the office and tossing her keys and the file on her desk Janelle grabbed the phone and scrolled for G & C's number. Then, feeling weird about the file, she put it in a drawer, just as Clark Wilson, a mid-level principal partner, walked by.

"Where's the fire?" asked Clark.

As she scrolled, she nodded toward the drawer. "I just literally picked up a file folder off the street. I saw Jonathan Draper drop it. I'm afraid to look at it."

Clark stared at her. "Oh, God! Hang up the phone!"

Janelle hung up and sat nervously as he stared at her. "This could be great! Is it about their plan for the Symphony Center?" She nodded.

Clark asked, "He didn't see you pick it up?" She shook her head, "I don't think so."

"Don't call anyone!" He suddenly changed his tone. "And don't look so worried. Look, Kiddo" he said, using a term she loathed. "Anybody could have picked up that folder—it just happened to be you! He may not even realize he dropped it." Clark opened the drawer and patted the file. "Well, we've got it now! Great work!"

Janelle barely managed a smile.

"Listen, I've got a meeting with Fiedler," Clark said. "I'll be back in a couple of hours. In the meantime, I want you to go through the file and give us some bullet points to gnaw on overnight. We just may find the clue to topping their proposal." He leaned over the desk. "I can't emphasize how crucial this contract is for our company."

Buoyed with confidence, he rapped the desk with his fist and headed for the door. "It's your baby now, Kiddo! You may have just saved us!"

Clark was gone.

Janelle sat for a moment, trying to catch her breath. "OK," she muttered, still holding on to the chair arms. "OK."

She got up and hurried to close the office door. That very act made her feel dirty somehow.

"OK. Just go over there, sit down, and do your job," she said aloud. Her conscience nagged at her as she sat down. *You're crossing a line*, she thought. She opened the drawer and stared at the file as Clark's voice echoed again in her brain, "It's your baby now, Kiddo! You may have just saved us!"

She reached for the file, opened it . . .. and paused. . . . . .

Questions

1. What would Janelle be thinking right now? What would you be thinking if in her position?
2. What do you think she should do? If she makes notes from the file, has she crossed an ethical line? Why?
3. What is the ethical responsibility of Clark Wilson and the architectural firm in this situation? Explain.

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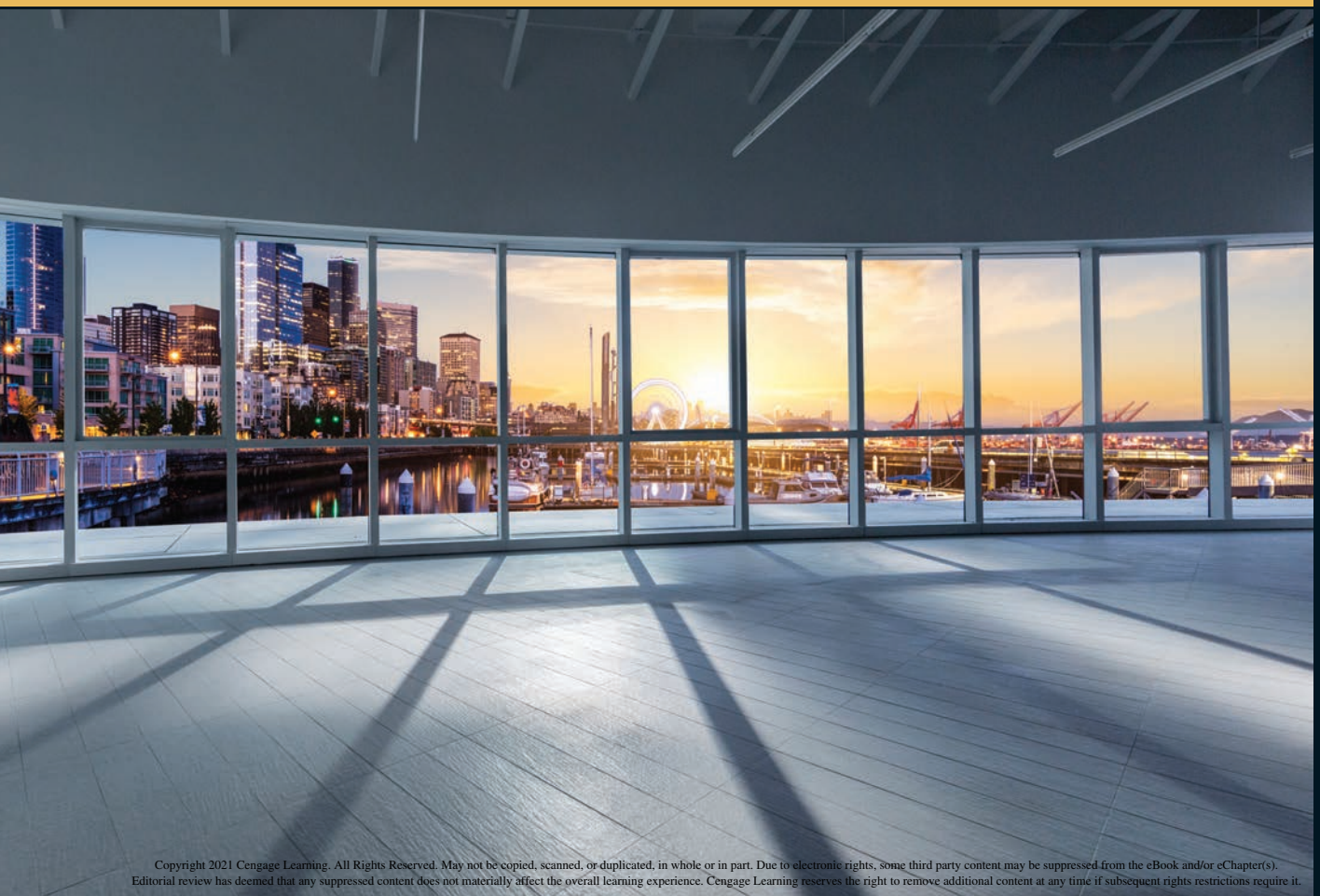
Internal Design Elements

PART 4

Chapter 8 Designs for Manufacturing and Service Technologies
Chapter 9 Designs for Digital Organizations and Big Data Analytics
Chapter 10 Organization Size, Life Cycle, and Decline



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CHAPTER

8 Designs for Manufacturing and Service Technologies

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Learning Objectives

After reading this chapter you should be able to:

1. Define an organization's core technology and its influence on organization design.
2. Explain Woodward's model of technical complexity, structure, and performance.
3. Apply the distinctive qualities of organization design that enable organizations to operate exceptionally complex technologies with few breakdowns and extremely rare catastrophes.
4. Compare service technology and manufacturing technology in terms of their impact on organization design.
5. Define departmental technology and its relationship to department design.
6. Identify three types of interdependence and their respective structural priority.

Chapter Outline

Core Manufacturing Technology

Manufacturing Firms · Strategy, Technology, and Performance · The Smart Factory · Mass Customization · Performance and Structural Implications

Surviving Extremely Complex Technologies

Extreme Technology Complexity · High Reliability Organizing

Core Service Technology

Service Firms · Designing the Service Organization

Noncore Departmental Technology

Variety · Analyzability · Framework · Department Design

Workflow Interdependence Among Departments

Types · Structural Priority · Structural Implications

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **One reason that high reliability organizations can operate exceedingly complex technologies, such as an aircraft carrier, without catastrophe is that employees are preoccupied with success rather than failure.**

I AGREE _____ **I DISAGREE** _____

2 **The best way for a company to provide good service is to have abundant and clear rules and procedures and make sure everyone follows them to the letter.**

I AGREE _____ **I DISAGREE** _____

3 **The design characteristics and management processes that are effective for a television station's sales department probably would not work so well for the news department.**

I AGREE _____ **I DISAGREE** _____

The plane is fueled up and ready to go. The pilots and the flight attendants are all on schedule. But you're still sitting in the terminal with other frustrated passengers, some of whom are fuming at the same old excuse: "We've got a technology problem." Across the terminal, passengers are ranting at airline employees—American, JetBlue, Alaska Airlines—it seems it doesn't matter which company you're flying with, you're stuck on no-go. How can so many airlines be experiencing technology problems at the same time? It's because of a snag in a state-of-the-art software system that multiple airlines use to manage fundamental back-end functions, including taking reservations, scheduling flight crews, tracking bookings, and calculating baggage weight. At any given moment, computer systems at travel technology companies such as Sabre and Amadeus are tracking hundreds of millions of pieces of data. These systems touch virtually every essential part of an airline's operations and generally help airlines run smoothly and efficiently. Yet, if one part of the system goes down for just a few minutes, it can create a backlog that might take hours or days to recover from. "No technology will be 100 percent perfect 100 percent of the time," said Henry Harteveldt, the founder of Atmosphere Research Group. Harteveldt adds that companies like Sabre are always striving to improve their product—they know "customers are sick and tired of being told: 'We've got a technology problem.'"[1]

Harteveldt's quote is relevant not only to airline executives and top leaders at Sabre, Amadeus, and other travel technology companies, but to managers in all types of organizations, from a large retail store to a small company that manufactures custom clothing. Today, every company is a technology company because Internet connectivity, automation, and new technologies like artificial intelligence are reaching into every facet of organizations.[2] In one survey of CEOs, technology topped the list of external forces that executives expect to significantly influence their organizations over the next few years.[3]

This chapter explores both service and manufacturing technologies. **Technology** refers to the work processes, techniques, machines, and actions used to transform organizational inputs (materials, information, ideas) into outputs (products and services).[4] Technology is an organization's production process and includes work procedures as well as machinery.

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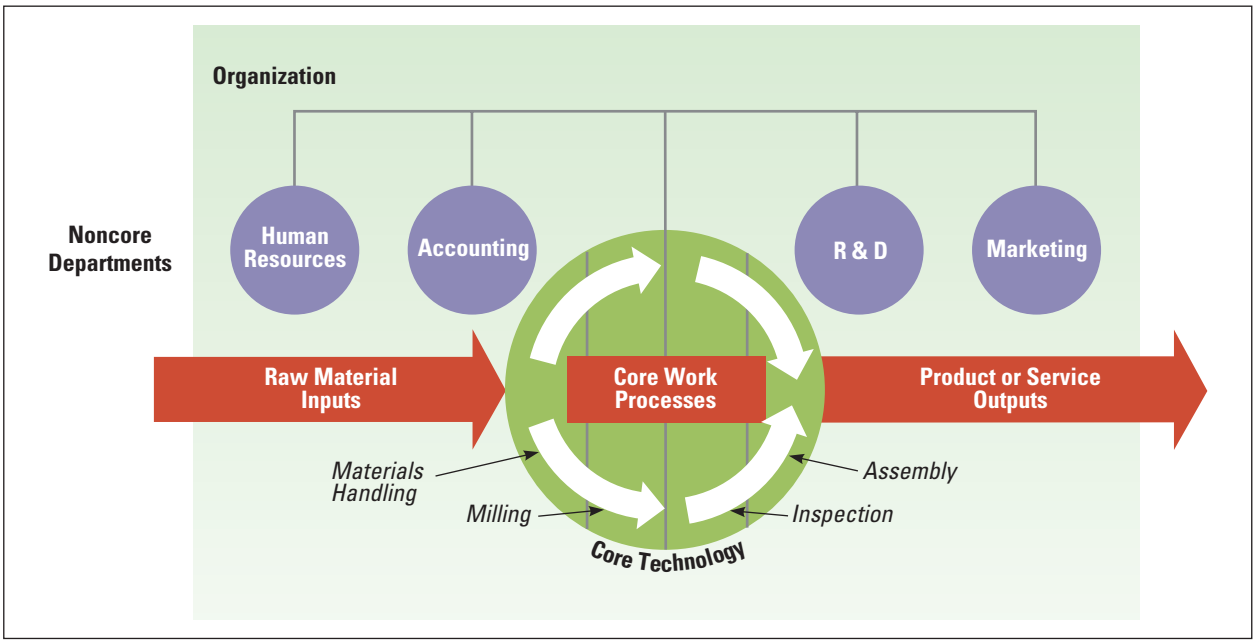
One important theme in this chapter is how core technology influences organization design. Understanding core technology provides insight into how an organization can be designed for efficient performance.[5] An organization's **core technology** is the work process that is directly related to the organization's mission, such as teaching in a high school, medical services in a health clinic, or manufacturing at American Axle & Manufacturing (AAM). At AAM, the core technology begins with raw materials (e.g., steel, aluminum, and composite metals). Employees take action on the raw material to make a change in it (e.g., they cut and forge metals and assemble parts), thus transforming the raw material into the output of the organization (e.g., axles, drive shafts, crankshafts, and transmission parts). For a service organization like UPS, the core technology includes the production equipment (e.g., sorting machines, package handling equipment, trucks, and airplanes) and procedures for delivering packages and overnight mail. In addition, as at companies like UPS and AAM, computers and digital information technology have revolutionized work processes in both manufacturing and service organizations. The specific impact of new digital technologies on organizations will be described in Chapter 9.

Exhibit 8.1 features an example of core technology for a manufacturing plant. Note how the core technology consists of raw material inputs, a transformation work process (e.g., milling, inspection, assembly) that changes and adds value to the raw material and produces the ultimate product or service output that is sold to consumers in the environment. In today's large, complex organizations, core work processes vary widely and sometimes can be hard to pinpoint. A core technology can be partly understood by examining the raw materials flowing into the organization,[6] the variability of work activities,[7] the degree to which the production process is mechanized,[8] the extent to which one task depends on another in the workflow,[9] or the number of new product or service outputs.[10]

EXHIBIT 8.1
Core Transformation Process for a Manufacturing Company



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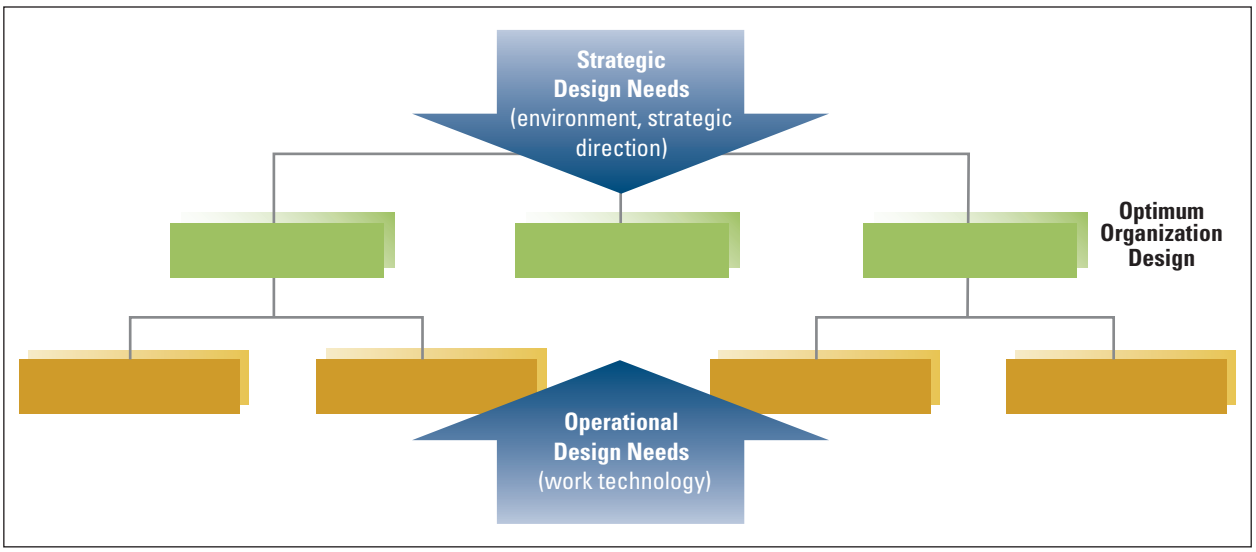
Organizations are also made up of many departments, each of which may use a different work process (technology) to provide a good or service within the organization. A **noncore technology** is a department work process that is important to the organization but is not directly related to its primary mission. In Exhibit 8.1, noncore work processes are illustrated by the departments of human resources (HR), accounting, research and development (R&D), and marketing. Thus, R&D transforms ideas into new products, and marketing transforms inventory into sales, each using a somewhat different work process. The output of the HR department is people to work in the organization, and accounting produces accurate statements about the organization's financial condition.

Purpose of This Chapter

In this chapter, we discuss both core and noncore work processes and their relationship to organization design. The nature of the organization's work processes must be considered in designing the organization for maximum efficiency and effectiveness. The optimum organization design is based on a variety of elements. Exhibit 8.2 illustrates that forces affecting organization design come from both outside and inside the organization. External strategic needs, such as environmental conditions, strategic direction, and organizational goals, create top-down pressure for designing the organization in such a way as to fit the environment and accomplish goals. These pressures on design have been discussed in previous chapters. However, decisions about design should also take into consideration pressures from the bottom up—from the work technology that is used to produce the organization's products or services. The operational technology and work processes will influence the structural design associated with both the core technology and noncore departments. Thus, the subject with which this chapter is concerned is, "How should the organization be designed to accommodate and facilitate its operational work technology?"

EXHIBIT 8.2
Pressures Affecting Organization Design



Source: Based on David A. Nadler and Michael L. Tushman, with Mark B. Nadler, *Competing by Design: The Power of Organizational Architecture* (New York: Oxford University Press, 1997), 54.

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The remainder of the chapter will unfold as follows. First, we examine how the technology for the organization as a whole influences organization structure and design. This discussion includes both manufacturing and service technologies. Second, we examine differences in departmental technologies and how the technologies influence the design and management of organizational subunits. Third, we explore how interdependence—flow of materials and information—among departments affects organization design.

8.1 Core Manufacturing Technology

Manufacturing technologies include traditional manufacturing processes and contemporary applications, such as the smart factory and mass customization.

8.1a Manufacturing Firms

The first and most influential study of manufacturing technology was conducted by Joan Woodward, a British industrial sociologist. Her research began as a field study of management principles in south Essex. The prevailing management wisdom at the time (1950s) was contained in what were known as universal principles of management. These principles were "one best way" prescriptions that effective organizations were expected to adopt. Woodward surveyed 100 manufacturing firms first hand to learn how they were organized.[11] She and her research team visited each firm, interviewed managers, examined company records, and observed the manufacturing operations. Her data included a wide range of structural characteristics (e.g., span of control, levels of management), dimensions of management style (e.g., written versus verbal communications, use of rewards), and the type of manufacturing process. She also collected data that reflected the commercial success of the firms.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Use the categories developed by Woodward to diagnose whether the production technology in a manufacturing firm is small-batch, mass production, or continuous process. Use a more organic structure with small-batch or continuous process technologies and with smart manufacturing systems. Use a mechanistic structure with mass-production technologies.

Woodward developed a scale and organized the firms according to the technical complexity of the manufacturing process. **Technical complexity** represents the extent of mechanization of the manufacturing process. High technical complexity means most of the work is performed by machines. Low technical complexity means workers play a larger role in the production process. Woodward's scale of technical complexity originally had 10 categories, as summarized in Exhibit 8.3. These categories were further consolidated into three basic technology groups, as follows:

- *Group I: Small-batch and unit production.* These firms tend to be job shop operations that manufacture and assemble small orders to meet specific needs of customers. Custom work is the norm. **Small-batch production** relies heavily on the human operator; it is thus not highly mechanized. One example of small-batch production is Hermes International's Kelly handbag, named after the late actress Grace Kelly. Craftsmen stitch the majority of each $7,000 bag by hand and sign it when they finish.[12] A traditional distribution center at Amazon might also be considered a small-batch service operation. Workers pick products off shelves and assemble orders one at a time for customers.

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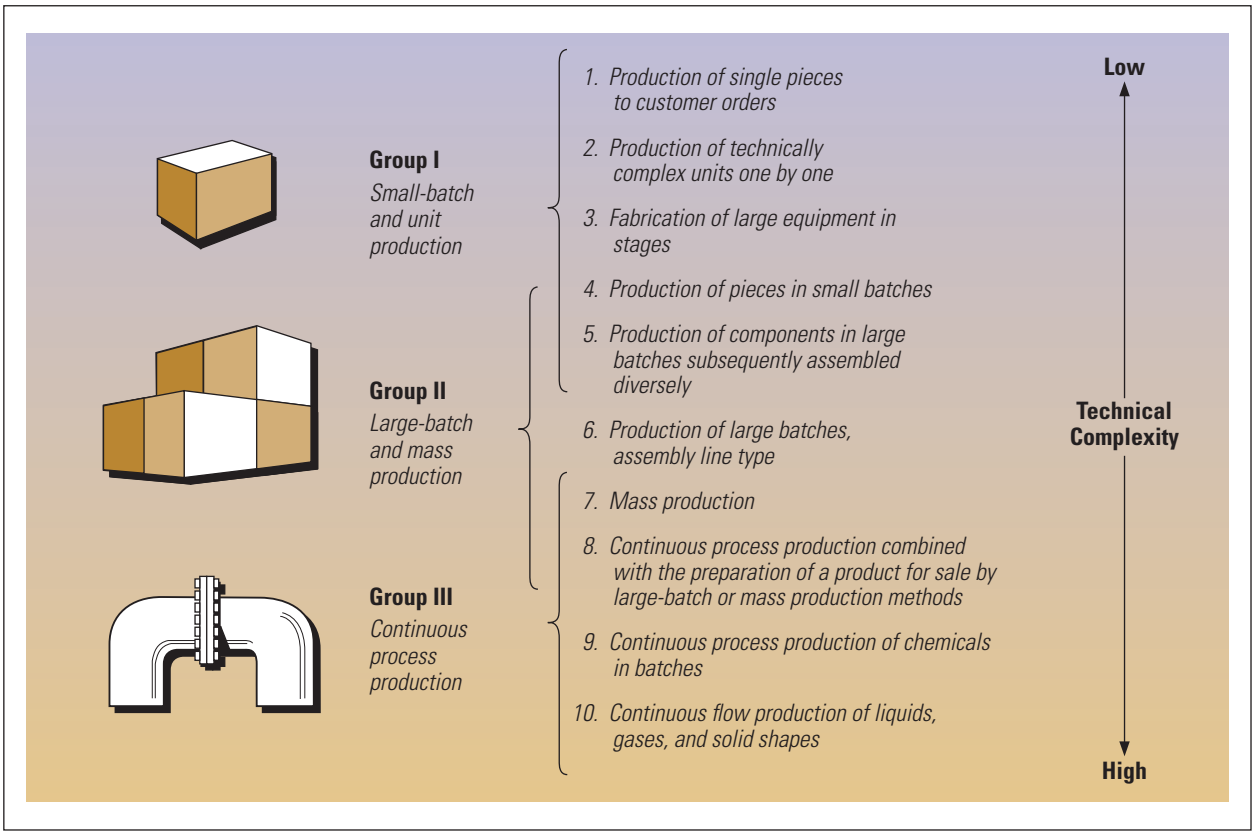
EXHIBIT 8.3

Woodward's Classification of 100 British Firms According to Their Systems of Production


Group I
Small-batch and unit production
Group II
Large-batch and mass production
Group III
Continuous process production
1. Production of single pieces to customer orders
2. Production of technically complex units one by one
3. Fabrication of large equipment in stages
4. Production of pieces in small batches
5. Production of components in large batches subsequently assembled diversely
6. Production of large batches, assembly line type
7. Mass production
8. Continuous process production combined with the preparation of a product for sale by large-batch or mass production methods
9. Continuous process production of chemicals in batches
10. Continuous flow production of liquids, gases, and solid shapes
Low
Technical Complexity
High

Source: Adapted from Joan Woodward, *Management and Technology* (London: Her Majesty's Stationery Office, 1958). Used with permission of Her Britannic Majesty's Stationery Office.

- *Group II: Large-batch and mass production.* **Large-batch production** is a manufacturing process characterized by long production runs of standardized parts. Output often goes into inventory from which orders are filled because customers do not have special needs. Examples include traditional assembly lines, such as for automobiles.
- *Group III: Continuous process production.* In **continuous process production**, the entire process is mechanized. There is no starting and stopping. This represents mechanization and standardization one step beyond those in an assembly line. Automated machines control the continuous process, and outcomes are highly predictable. Examples include chemical plants, oil refineries, liquor producers, pharmaceuticals, and nuclear power plants. Royal Dutch Shell's new "Pearl GTL" (gas-to-liquid) plant in Qatar provides an illustration. At the new processing facility, natural gas flows through a maze of pipes, storage tanks, gasification units, distillers, reactors, and other equipment, while highly skilled employees monitor operations from a central control room. GTL uses chemical processes to physically change the composition of gas molecules to produce a colorless, odorless fuel similar to diesel but without diesel's pollutants.[13] Amazon's fully

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automated distribution centers could also be considered continuous process production. Robots bring all the items needed for a customer's order to a worker. Other robots then take the filled boxes to the shipping door.[14]

Using this classification of technology, Woodward's data made sense. A few of her key findings are given in Exhibit 8.4. The number of management levels and the manager-to-total personnel ratio, for example, show definite increases as technical complexity increases from unit production to continuous process. This indicates that greater management intensity is needed to manage complex technology. The direct-to-indirect labor ratio decreases with technical complexity because more indirect workers are required to support and maintain complex machinery. Other characteristics, such as span of control, formalized procedures, and centralization, are high for mass-production technology because the work is standardized, but low for other technologies. Unit (small-batch) production and continuous process technologies require highly skilled workers to run the machines and verbal communication to adapt to changing conditions. Mass production is standardized and routinized, so few exceptions occur, little verbal communication is needed, and employees are less skilled.

Overall, the structure and management systems in both unit production and continuous process technology are characterized as organic, as defined in Chapters 1 and 4. They are more free-flowing and adaptive, with fewer formal procedures and less standardization. Mass production, however, is mechanistic, with standardized jobs and formalized procedures. Woodward's discovery about technology thus provided substantial new insight into the causes of organization structure. In Joan Woodward's own words, "Different technologies impose different kinds of demands on individuals and organizations, and those demands had to be met through an appropriate structure."[15]

BRIEFCASE

As an organization manager, keep this guideline in mind:

When adopting a new technology, realign strategy, structure, and management processes to achieve top performance.

8.1b Strategy, Technology, and Performance

Another portion of Woodward's study examined the success of the firms along dimensions such as profitability, market share, stock price, and reputation. As

EXHIBIT 8.4
Relationship Between Technical Complexity and Structural Characteristics

Structural Characteristic	Technology		
	Unit Production	Mass Production	Continuous Process
Number of management levels	3	4	6
Supervisor span of control	23	48	15
Direct/indirect labor ratio	9:1	4:1	1:1
Manager/total personnel ratio	Low	Medium	High
Workers' skill level	High	Low	High
Formalized procedures	Low	High	Low
Centralization	Low	High	Low
Amount of verbal communication	High	Low	High
Amount of written communication	Low	High	Low
Overall structure	Organic	Mechanistic	Organic

Source: Based on *Management and Technology* by Joan Woodward (London: Her Majesty's Stationery Office, 1958).

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indicated in Chapter 2, the measurement of effectiveness is not simple or precise, but Woodward was able to rank firms on a scale of commercial success according to whether they displayed above-average, average, or below-average performance on strategic objectives.

Woodward compared the structure-technology relationship against commercial success and discovered that successful firms tended to be those that had complementary structures and technologies. Many of the organizational characteristics of the successful firms were near the average of their technology category, as shown in Exhibit 8.4. Below-average firms tended to depart from the structural characteristics for their technology type. Another conclusion was that structural characteristics could be interpreted as clustering into organic and mechanistic management systems, as defined in Chapters 1 and 4. Successful small-batch and continuous process organizations had organic designs, and successful mass production organizations had mechanistic designs. Subsequent research has replicated her findings.[16]

What this illustrates for today's companies is that strategy, structure, and technology need to be aligned, especially when competitive conditions change.[17] For example, consider changes in the mattress business that required Sealy to adopt a more organic design. With the increasing popularity of mattresses from Sleep Number and Tempur-Pedic, combined with a slowdown in the housing market, Sealy managers saw sales of the company's high-end Stearns & Foster line decline significantly. Sealy revamped how it designs mattresses, using cross-functional teams and joining with design firm IDEO to design a prettier bed that differentiated Stearns & Foster and tapped into people's belief that they were truly getting a premium product.[18] The company also adopted digital manufacturing technology to be more competitive in the new environment.

Failing to adopt appropriate new technologies to support strategy, or adopting a new technology and failing to realign strategy to match it, can lead to poor performance. Today's increased global competition means more volatile markets, shorter product life cycles, and more sophisticated and knowledgeable consumers; and flexibility to meet these new demands has become a strategic imperative.[19] Manufacturing companies can adopt new technologies to support the strategy of flexibility. However, organization design and management processes must also be realigned, as a highly mechanistic design hampers flexibility and prevents the company from reaping the benefits of the new technology.[20]

8.1c The Smart Factory

Most of today's factories use a variety of new manufacturing technologies, including advanced robotics, numerically controlled machine tools, radio-frequency identification (RFID), wireless technology, and computerized software and artificial intelligence (AI) for product design, engineering analysis, and remote control of machinery. A study found that manufacturers in the United States use more than six times the amount of information-processing equipment (computers, etc.) as they used 20 years ago.[21] This increase reflects the growing uncertainty and tough challenges manufacturing organizations face, including globalization of operations, increased competition, greater product complexity, and the need to coordinate with a larger number of business partners.[22] The ultimate automated factories are referred to as smart factories.[23] A **smart factory** is one in which computer-guided machines handle many of the routine tasks and factory plants are digitally connected to one another and to suppliers and customers in a digital supply chain network.[24]

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The smart factory typically includes several subcomponents:

- *Computer-aided design (CAD).* Computers are used to assist in the drafting, design, and engineering of new parts. Designers guide their computers to draw specified configurations on the screen, including dimensions and component details. Hundreds of design alternatives can be explored, as can scaled-up or scaled-down versions of the original.[25]
- *Computer-aided manufacturing (CAM).* Computer-controlled machines in materials handling, fabrication, production, and assembly greatly increase the speed at which items can be manufactured. CAM also permits a production line to shift rapidly from producing one product to any variety of other products by changing software codes in the computer. CAM enables the production line to quickly honor customer requests for changes in product design and product mix.[26]
- *Robots.* Automakers have been using large robots on the assembly line for years, but a new generation of smaller, simpler robots enables small and medium size manufacturers to benefit from them also. These new robots can communicate and collaborate with human employees and help with every phase of the manufacturing process, from delivering parts to assembling products to warehousing to packing and shipping.[27] Aided by new imaging and human interface software and advances in object detection and sensor technology, these robots can be used by manufacturers of all sizes because they can run "cage-free." They can sense and react to their "co-workers," have built-in safety mechanisms, and are capable of making commonsense decisions while performing repetitive tasks.[28]
- *3-D Printing.* Also known as *additive manufacturing*, 3-D printing builds objects one successive layer of material at a time. 3-D printing was initially used to make plastic mock-ups of CAD files and was referred to as rapid prototyping.[29] In the two decades since, the technology has evolved from prototyping into production, so that engineers can model an object on a computer and print it out with plastic, metal, or composite materials rather than cutting or drilling the object from molds. This results in less wasted materials, allows manufacturers to get products to customers more quickly, and enables on-site production of needed parts in remote locations such as oil rigs. For example, Navy ships are using 3-D printing to produce some parts on board.[30]

In a smart factory, a new product can be designed on the computer and produced untouched by human hands. Porsche is using 3-D printing technology to recreate obsolete parts for its classic car models with "absolute fidelity to the original specifications."[31] The ideal smart factory can switch quickly from one product to another, working fast and with precision, without paperwork or record keeping to bog down the system.[32] In addition, new software can coordinate information from multiple departments and organizations involved in a design, and virtual designs can even include an entirely new factory.

The Siemens Electronic Works facility in Amberg, Germany, is a good example of a smart factory. Its integrated smart machines coordinate the production and distribution of the company's SIMATIC control devices, which involves a custom, build-to-order process encompassing more than 1.6 billion components from 250 suppliers to make 950 different products in 50,000 annual product variations. And they do it all with a 99 percent reliability rate and record only about 15 defects per million.[33] Automakers also provide good examples of the benefits of the smart factory. Honda has achieved an amazing degree of flexibility at its plant in East Liberty, Ohio. Considered the most flexible auto manufacturer in North America,

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the Honda plant can switch from making Civic compacts to making the longer, taller CRV crossover in as little as five minutes. All that's needed to switch assembly from one type of vehicle to another is to put different "hands" on the robots to handle different parts. Employees at Nissan's Smyrna, Tennessee, plant make six different vehicles—three cars and three SUVs—on two production lines. A sophisticated high-tech system enables production to run smoothly and efficiently, with each line producing 60 vehicles an hour. "No matter which model comes down the line, the right parts are waiting for it," said Nissan's Ryan Fulkerson. The ability to quickly adjust inventory levels of different types of vehicles has been a key strategic advantage for Honda and Nissan in an era of volatile gasoline prices and shifting vehicle popularity.[34]

8.1d Mass Customization

The smart factory paved the way for **mass customization**, which refers to using mass-production technology to quickly and cost-effectively assemble goods that are uniquely designed to fit the demands of individual customers. The goal is to provide customers with exactly what they want when they want it.[35] A customer can order a Dell laptop with one of several hard drive capacities, processing chip speeds, and software packages, or a BMW automobile with the exact combination of features and components desired. Mass customization has been applied to products as diverse as farm machinery, water heaters, clothing, computers, industrial detergents, and hearing aids.[36] For hearing aids, customer data from local audiologists and other professionals who treat hearing loss, such as customer's level of hearing loss and ear measurements, are fed into the customized mass production line. There have to be enough custom orders to keep an assembly line operating continuously; otherwise, the production would be more like a small-batch process. Invisalign uses mass customization production for its customized dental straighteners, and Tailored Fits uses mass customization to make custom orthotics for sports shoes and ski boots.[37] Oshkosh Truck Company thrived during an industry-wide slump in sales by offering customized fire, cement, garbage, and military trucks. Firefighters often travel to the plant to watch their new vehicle take shape, sometimes bringing paint chips to customize the color of their fleet.[38]

The awesome advantage of the smart factory is that products of different sizes, types, and customer requirements freely intermingle on the assembly line, enabling large factories to deliver a wide range of custom-made products at low mass-production costs.[39] Computerized machines can make instantaneous changes—such as putting a larger screw in a different location—without slowing the production line. A manufacturer can turn out an infinite variety of products in unlimited batch sizes, as illustrated in Exhibit 8.5. In traditional manufacturing systems studied by Woodward, choices were limited to the diagonal. Small-batch allowed for high product flexibility and custom orders, but because of the "craftsmanship" involved in custom-making products, batch size was necessarily small. Mass production could have large batch size but offered limited product flexibility. Continuous process could produce a single standard product in unlimited quantities. The smart factory allows plants to break free of this diagonal and to increase both batch size and product flexibility at the same time. When taken to its ultimate level, the smart factory allows for mass customization, with each specific product tailored to customer specification. This high-level use of smart systems has been referred to as *computer-aided craftsmanship*.[40]

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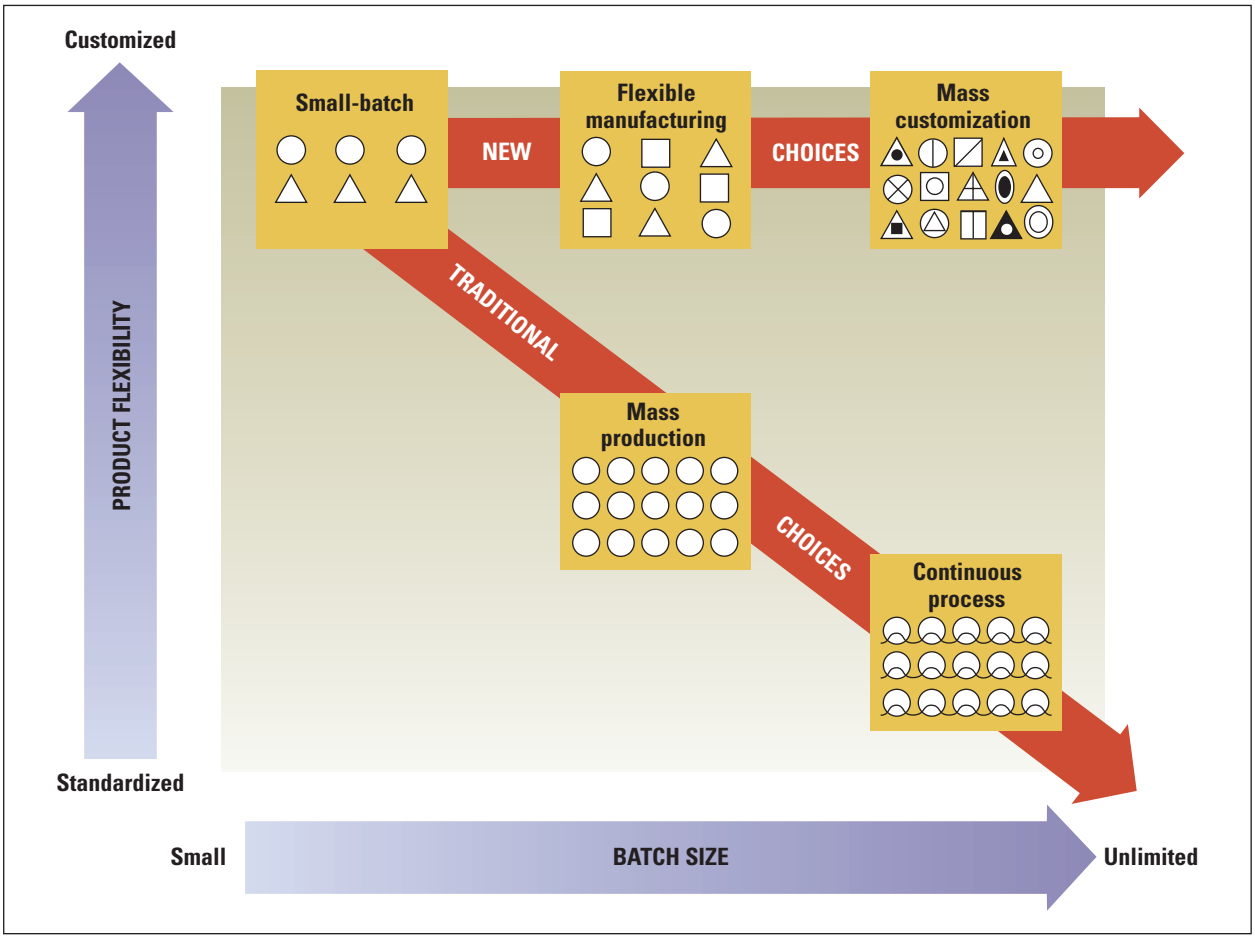
EXHIBIT 8.5
Relationship of Smart Manufacturing Technology to Traditional Technologies



Source: Based on Jack Meredith, "The Strategic Advantages of New Manufacturing Technologies for Small Firms," *Strategic Management Journal* 8 (1987), 249–258; Paul Adler, "Managing Flexible Automation," *California Management Review* (Spring 1988), 34–56; and Otis Port, "Custom-made Direct from the Plant," *BusinessWeek/21st Century Capitalism*, November 18, 1994, 158–159.

8.1e Performance and Structural Implications

Studies suggest that in smart factories, machine utilization is more efficient, labor productivity increases, scrap rates decrease, and product variety and customer satisfaction increase.[41] Many U.S. manufacturing companies are reinventing the factory using digital systems and mass customization.

Research into the relationship between the smart factory and organizational characteristics has discovered the organizational patterns summarized in Exhibit 8.6. Compared with traditional mass-production technologies, the smart factory has a narrow span of control, few hierarchical levels, adaptive tasks, low specialization, and decentralization, and the overall environment is characterized as organic and self-regulative. Employees need the skills to participate in teams; training is broad (so workers are not overly specialized) and frequent (so workers are up to date). Expertise tends to be cognitive so workers can process abstract ideas and solve problems. Interorganizational relationships in smart factories are characterized by changing demand from customers—which is easily handled with the new technology—and close relationships with a few suppliers that provide top-quality raw materials.[42]

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Characteristic	Mass Production	Smart Factory
Structure		
Span of control	Wide	Narrow
Hierarchical levels	Many	Few
Tasks	Routine, repetitive	Adaptive, craftlike
Specialization	High	Low
Decision making	Centralized	Decentralized
Overall	Bureaucratic, mechanistic	Self-regulating, organic
Human Resources		
Interactions	Stand-alone	Teamwork
Training	Narrow, one time	Broad, frequent
Expertise	Manual, technical	Cognitive, social; solve problems
Interorganizational		
Customer demand	Stable	Changing
Suppliers	Many, arm's length	Few, close relationships

EXHIBIT 8.6 Comparison of Organizational Characteristics Associated with Mass Production and Smart Factories

Sources: Based on Patricia L. Nemetz and Louis W. Fry, "Flexible Manufacturing Organizations: Implications for Strategy Formulation and Organization Design," *Academy of Management Review* 13 (1988), 627–638; Paul S. Adler, "Managing Flexible Automation," *California Management Review*, Spring 1988, 34–56; and Jeremy Main, "Manufacturing the Right Way," *Fortune*, May 21, 1990, 54–64.

Technology alone cannot give organizations the benefits of flexibility, quality, increased productivity, and greater customer satisfaction. Research suggests that organizational structures and management processes also must be redesigned to take advantage of the new technology.[43] When top managers make a commitment to implement new structures and processes that empower workers and support a learning and knowledge-creating environment, the smart factory can help companies be more competitive.[44]

REMEMBER THIS

- An organization's core technology is the work process that is directly related to the organization's mission. A noncore technology is a department work process that is important to the organization but is not directly related to its mission.
- Woodward studied manufacturing technology and classified firms as small-batch, large-batch, or continuous process production based on their technical complexity. In general, the structure and management processes in small-batch and continuous process production are characterized as organic. Mass production is typically more mechanistic.
- Woodward's research found clear relationships between technology and structure in high-performing organizations. Managers can use these findings to analyze their own organizations along the same dimensions of technology and structure. In addition, technology and structure can be co-aligned with organizational strategy to meet changing needs and provide new competitive advantages.
- Smart factories and mass customization are being adopted by organizations and having impact on organization design. For the most part, the impact is positive, with shifts toward more organic designs both on the shop floor and in the management hierarchy. These technologies replace routine jobs, give employees more autonomy, produce more challenging jobs, encourage teamwork, and let the organization be more flexible and responsive.

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8.2 Surviving Extremely Complex Technologies

The factory of today is far different from the industrial firms Woodward studied in the 1950s. In particular, computers and digital technology have revolutionized all types of manufacturing—small-batch, large-batch, and continuous process. At the Marion, North Carolina, plant of Rockwell Automation's Power Systems Division, for example, highly trained employees can quickly handle a build-on-demand unit of one, thanks to computers, wireless technology, and RFID systems. In one instance, the Marion plant built, packaged, and delivered a replacement bearing for installation in an industrial air-conditioning unit in Texas only 15 hours after the customer called for help.[45] As illustrated by the chapter's opening example, technology has also transformed the service industry. There are both positive and negative aspects of the increasing complexity of technology.

8.2a Extreme Technology Complexity

You would have to be a hermit not to realize that we live in an increasingly complex and interconnected world. Considering just the Internet and social media, it is easy to see that our personal lives, our finances, and our jobs are part of a huge, interconnected global network. Advances in technology have made possible the creation of extremely complex systems that bring about many benefits, but these systems can sometimes overwhelm our ability to effectively and safely manage them.

Organizations in many industries are coping with extreme complexity brought about by advancing technology. The inability to safely manage complex nuclear technology led to dangerous radiation leaks at Japan's Fukushima Daiichi nuclear power plant following a massive earthquake and tsunami. On Wall Street, a faulty software update at Knight Capital caused the unintentional automated trading of billions of dollars of stock that resulted in a loss of more than $450 million in the first half-hour of trading. The company's high-frequency trading algorithms had made Knight Capital the largest trader in U.S. equities in early 2012, but when flawed software overwhelmed the firm's safety features, the complex technology created losses from which the company never recovered.[46] In the medical industry, technology mix-ups can be even more devastating. A high-tech prescription system nearly caused the death of a 16-year-old boy at one of the world's best hospitals after he was given 38 pills rather than the single pill the doctor had intended him to have.[47]

In the manufacturing world, consider Boeing's production of its 737 Max 8, which resulted in crashes in Indonesia and Ethiopia in 2018 and 2019, killing all aboard. Countries around the world grounded the plane for a software glitch that pilots were not trained to handle. Subsequent investigation found a string of interconnected problems, including the software problem, a potentially defective sensor, rushed production because of competition with the Airbus A320neo, a larger diameter engine for fuel efficiency that extended too close to the ground on the standard 737 airframe, and an FAA that delegated too much inspection responsibility to Boeing. In addition, the Max 8 included a large number of plane options, including a warning light to tell pilots when the sensors disagreed, that cost extra money (and Indonesian and Ethiopian airlines did not purchase).[48] Decisions made independently for each issue interacted to cause a catastrophe for the perished passengers and crews. Service companies such as cruise lines also struggle from pushing the boundaries of new technology.

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IN PRACTICE
Carnival Cruise Lines

A string of incidents at Carnival Cruise Lines had some customers vowing never to cruise with Carnival again. In one of the worst episodes, an engine room fire left the Carnival Triumph stranded without power in the Gulf of Mexico with 4,200 people on board. As the four-day cruise doubled in length, food and water were scarce, passengers sweltered with no air-conditioning, and the media reported overflowing toilets and described the scene as "hellish." Carnival managers are re-evaluating the strategy of building ever larger ships that are almost too complex to handle when an emergency arises.

The dangers of that strategy became most visible when the Costa Concordia ran aground and capsized off the coast of Italy, killing 32 people. The accident revealed fatal flaws in Carnival's safety and emergency procedures. Captain Francesco Schettino made many errors and is said to have contributed to the crisis by failing to respond for 45 minutes after the crew told him that the ship was flooding and its motors were dead. However, part of the danger also came from the huge size of the ship and the lack of industry oversight. Today's largest cruise ships are nearly five times the size they were in 1985.[49]

The recent spate of accidents in the cruise industry has prompted safety experts and regulators to push for more accountability, saying the strategy of building supersize ships is fraught with risk. "Given the size of today's ships, any problem immediately becomes a very big problem," said Michael Bruno, dean of the engineering school at the Stevens Institute of Technology.[50] This chapter's BookMark provides a deeper look at the dangers of failing to understand and effectively manage extremely complex technologies.

BOOKMARK 8.0 HAVE YOU READ THIS BOOK?

Meltdown: Why Our Systems Fail and What We Can Do About It

By Chris Clearfield and András Tilcsik

Ceasar Medina was just 17 years old when he was shot and killed in a robbery attempt at his uncle's Spokane-area tattoo shop. Family and friends were understandably heartbroken, but they were outraged when they learned that their loved one died because of a computer glitch. The man who killed Medina was supposed to be in prison at the time. He hadn't escaped. He was one of thousands of inmates that the Washington State Department of Corrections accidentally released because of a software bug that miscalculated prisoner release dates. It's just one of the technology-related disasters Chris Clearfield and András Tilcsik describe in their book, *Meltdown: Why Our Systems Fail and What We Can Do About It*.

One of the authors' main points is that advancing technology makes possible the creation of machines that strain the human ability to understand and safely operate them. In their words, they look at "how simple human errors spiral out of control in complex technological systems."

HOW THINGS SPIRAL OUT OF CONTROL

Clearfield and Tilcsik assert that we "are in the golden age of meltdowns," with more and more of our systems in the danger zone because our ability to manage the technology hasn't caught up. The authors remind us that technological advances have always been a challenge, citing historical examples such as the Three Mile Island nuclear meltdown in 1979, which resulted not from a massive external event such as an earthquake or terrorist attack, but from the interaction of a series of small mistakes and

(continued)

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malfunctions—including a plumbing problem, a maintenance crew's slipup, a valve that was stuck open, and a series of confusing indicators in the control room.

A complex system is like an elaborate web, with many parts that are intricately linked and can easily affect one another. On a traditional assembly line, people can look directly at what's happening, but in a complex technology like a nuclear power plant, people have to piece together a complete picture of what is going on based on small pieces of data from pressure indicators, water flow measurements, and so forth. Small errors can combine and spread quickly and uncontrollably. In a complex and tightly coupled system, "massive failures come not from external shocks or bad apples, but from combinations of technological glitches and ordinary human mistakes."

WHAT'S THE ANSWER?

Managers can't turn back the clock and abandon computers and other complex technologies, so Clearfield and Tilcsik offer guidance on how to more effectively manage complex, tightly coupled systems. They use the example of mountaineering companies that have made climbing expeditions safer by treating mundane details and boring logistical issues like critical safety concerns. Other organizations are learning a similar lesson:

- Novo Nordisk set up a department made up of about 20 people specifically charged with scanning for small problems or challenges that managers might ignore or not have time to think about. The company also assigned facilitators—two dozen or so of the company's most respected managers—to make sure problems don't get stuck at the bottom of the hierarchy. The facilitators work with every unit to identify small issues that might otherwise be ignored.
- NASA's Jet Propulsion Laboratory (JPL) began using risk review boards that are made up of scientists and engineers who may work at JPL, NASA, or contract firms. The key is that none of the reviewers are associated with the missions they review, so their outlook isn't clouded by the same assumptions mission insiders may have. JPL also created an Engineering Technical Authority made up of outsiders. "Such channels for scepticism are indispensable in the danger zone," Clearfield and Tilcsik, point out, "because the ability of any one individual to know what's going on is limited, and the cost of being wrong is just too high."

Meltdown: Why Our Systems Fail and What We Can Do About It, by Chris Clearfield and András Tilcsik, is published by Penguin Press.

8.2b High Reliability Organizing

Research into highly complex and hazardous technologies that appear to function without mishap has provided some insight into how organizations can manage today's level of extreme complexity. A **high reliability organization (HRO)** is one that has developed techniques to manage highly complex and potentially hazardous technologies in a safe and reliable manner. The original research on HROs was based on three organizations in the United States that appeared to function without mishap despite operating potentially dangerous technologies—a U. S. Navy nuclear aircraft carrier operation, the U. S. air traffic control system, and a nuclear power station.[51] The researchers found that these organizations formulated processes and systems that provided a sense of reliability and safety when the underlying potential for disaster seemed high.

Major industrial accidents are rare, and when they do happen a catastrophe results, serving as a reminder about how successfully most HROs operate. For example, the Union Carbide pesticide plant explosion in Bhopal, India, caused more than 15,000 deaths and perhaps as many as 100,000 injuries, and the Chernobyl nuclear power station explosion in the Ukraine caused about 4,000 deaths.[52] More recent catastrophes include the bungled federal response to Hurricane Katrina in 2005, the BP Deepwater Horizon drilling rig explosion and subsequent oil spill in the Gulf of Mexico during the summer of 2010, and the Fukushima, Japan nuclear disaster following a tsunami in 2011. How is it that some organizations can operate in highly complex environments for extended periods of time without experiencing similar catastrophes or even smaller accidents? The answer lies in high reliability organizing.

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The mindset in an HRO is that "failure is not an option." Consider the small miracle that happened when a NASA moon rocket launched successfully because there were a million accidents waiting to happen *that didn't*. Research into the underpinnings of why serious accidents don't happen illustrates how specific practices allow organizations to sense, see, and reconfigure in response to the unexpected to sustain superior performance.[53]

The high reliability organization is a commitment to eliminating the small mistakes that could eventually lead to disasters. High reliability organizations create an environment in which everyone looks for and reports small problems or unsafe conditions so they can be resolved before they pose a substantial risk. HROs take pride in the identification of errors and close calls because of the lessons learned from those events. Five qualities characterize a high reliability organization. These five qualities are illustrated in Exhibit 8.7, and each is discussed in the following sections.[54]

Preoccupation with Failure. HROs focus on preventing and eliminating catastrophes rather than reacting to them. Finding and correcting small errors is front of mind. People are trained to constantly think about what they may have missed that would increase the risk of a failure. A "near miss" is treated as an opportunity by taking time to debrief the event, determining weaknesses, and devoting resources to address them. People are taught to never be satisfied simply because there has not been an accident for many months or years. The cultural norm is to always be alert to the smallest signal that may mean a new threat to safety is developing. Management practices encourage employees to question operational deviations and reward people for reporting errors and mistakes.

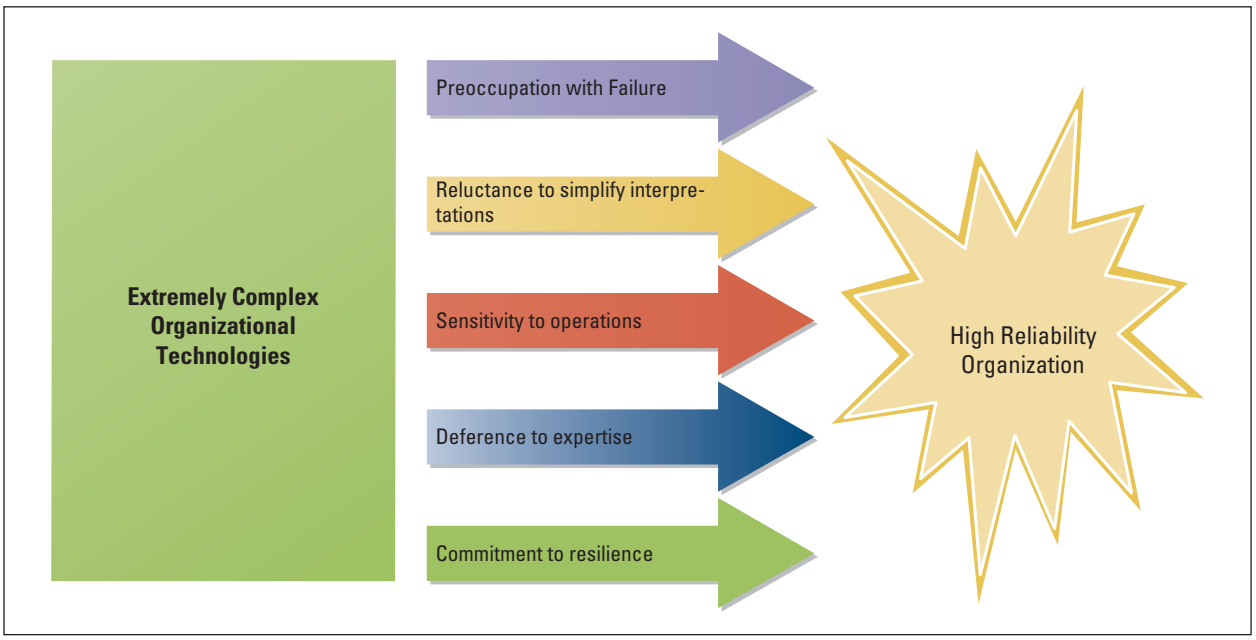
BRIEFCASE

As an organization manager, keep these guidelines in mind:

Use the characteristics of a high reliability organization to reduce the risk of catastrophe in technologically complex organizations. Adopt a culture of preoccupation with failure, reluctance to simplify, sensitivity to operations, deference to expertise, and resilience to decrease the risk of disastrous failures.

EXHIBIT 8.7

Five Characteristics of the High Reliability Organization



Source: Adapted from Figure 1, State of Mindfulness, in Paul Chivers, "Why More Businesses Need to Emulate High Reliability Organizations," *Governance Directions* (February 2014), 16–20.

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Reluctance to Simplify Their Observations. The human mind often simplifies observations by inferring conclusions with minimal data. Simplification increases the likelihood of a future error being overlooked and then paying the price. Simplification allows anomalies to accumulate without deeper inquiry. Being able to identify the often subtle differences among threats may make the difference between early and late responses. HROs do not simplify deeper examinations of small difficulties or problems that arise. People in these organizations accept that their work is complex and do not accept simplistic solutions, even to seemingly simple problems. They know that their systems can fail in ways never before seen and that they cannot identify all the ways failure might occur in the future. People in HROs do not make assumptions or inferences about a simple, single cause because they know a failure can be caused by many things. In an HRO, the rules are: Do not simplify and generalize. Encourage skepticism and differences of opinion.

Sensitivity to Operations. In an HRO, people recognize that manuals and policies change along with the complexity of their work systems, so they stay alert rather than fall into an expected routine. Situational awareness is essential because the early indicators of threats to organizational performance typically appear as small changes in the organization's operations. HRO sensitivity reduces the likelihood of errors and enables faster identification and correction before mistakes accelerate and accumulate. In an HRO, people look for loopholes or ambiguities in supervision, reporting, safety procedures, safety training, and briefings. Sensitive awareness means early detection. Mindful attention to operations rather than mindless repetition is central to high reliability organizations.

Deference to Expertise. When confronted with a new threat, HROs have mechanisms in place to identify the individuals with the greatest expertise relevant to handling the event and to place decision-making authority in the hands of that person or group. Team members and organizational leaders are taught to defer to the person with the most knowledge relevant to the issue at hand. During routine operations, employees defer to hierarchical authority. However, the people who see the key risk indicators tend to be those on the front line, who are often lower ranking in the hierarchy. When expertise is high with lower-ranking personnel, their interpretation and recommendation regarding a threat will take precedence over higher-ranking personnel. HROs strive to make decisions quickly and accurately when the operations tempo changes. An HRO also cultivates diversity of people and perspectives to deal with complexity, pushes decision making down to the front line, and gives situational authority to the people with the most expertise, regardless of rank.

ASSESS YOUR ANSWER

1 One reason that high reliability organizations can operate exceedingly complex technologies, such as an aircraft carrier, without catastrophe is that employees are preoccupied with success rather than failure.

ANSWER: *Disagree.* The culture norm in a high reliability organization is to be preoccupied with failure. In an HRO, people are constantly thinking about failure and focused on looking at small mistakes that could increase the risk of a catastrophe. A preoccupation with failure helps people in an HRO prevent a disaster rather than reacting to one after it happens.

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Commitment to Resilience. The value of resilience is as much to ensure things go right as to prevent things from going wrong. HRO employees are constantly alert to small mistakes. They respond with quick situational assessments, swiftly containing errors and improvising solutions when difficulties arise. Systems can continue functioning despite a setback. People are prepared and trained in advance for an emergency. HROs recognize the importance of maintaining normal operations, even when something has gone wrong. Leaders encourage flexibility and provide training on how to manage through unexpected events. In addition, if people are afraid that errors will be met with skepticism or rejection, they won't report unsafe conditions. Managers encourage and reward front-line employees for reporting errors and unsafe conditions. People have to trust that their leaders want to know what is not working. High reliability organizations create positive responses across many small events and close calls to identify which of their systems need improvement.

Many hospitals and healthcare organizations have embraced the HRO concept. All organizations that have complex technologies, cope with the potential for catastrophic failures, or want to achieve near-perfect performance can emulate the HRO model. Any organization can incorporate HRO characteristics, attaining a new level of confidence in achieving objectives as well as increasing resilience after mistakes, thereby bolstering the organization's long-term survivability.

REMEMBER THIS

- Computers and digital technology have revolutionized both manufacturing and service organizations.
- Advances in technology have made possible the creation of extremely complex systems that bring about many benefits, but these systems can strain the human ability to effectively and safely manage them.
- A high reliability organization (HRO) develops techniques to manage highly complex and potentially hazardous technologies in a safe and reliable manner.
- The five qualities that characterize an HRO are: preoccupation with failure, reluctance to simplify observations, sensitivity to operations, deference to expertise, and commitment to resilience.

8.3 Core Service Technology

Another big change occurring in the technology of organizations is the growing service sector. More than half of all businesses in the United States are service organizations, and according to one estimate nearly 90 percent of the U.S. workforce is employed in services, such as restaurants, hospitals, hotels and resorts, airlines, retail, financial services, and information services.[55]

8.3a Service Firms

Service technologies are different from manufacturing technologies and, in turn, require a different organization design. The ideas, assumptions, and management mindset that are effective for a traditional manufacturing firm can be damaging to a service organization because service technologies require a different approach.[56]

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BRIEFCASE

As an organization manager, keep these guidelines in mind:

Use the concept of service technology to evaluate the production process in nonmanufacturing firms. Services are intangible and must be located close to the customer. Hence, service organizations may have an organization design with fewer boundary roles, greater geographical dispersion, decentralization, highly skilled employees in the technical core, and generally less control than in manufacturing organizations.

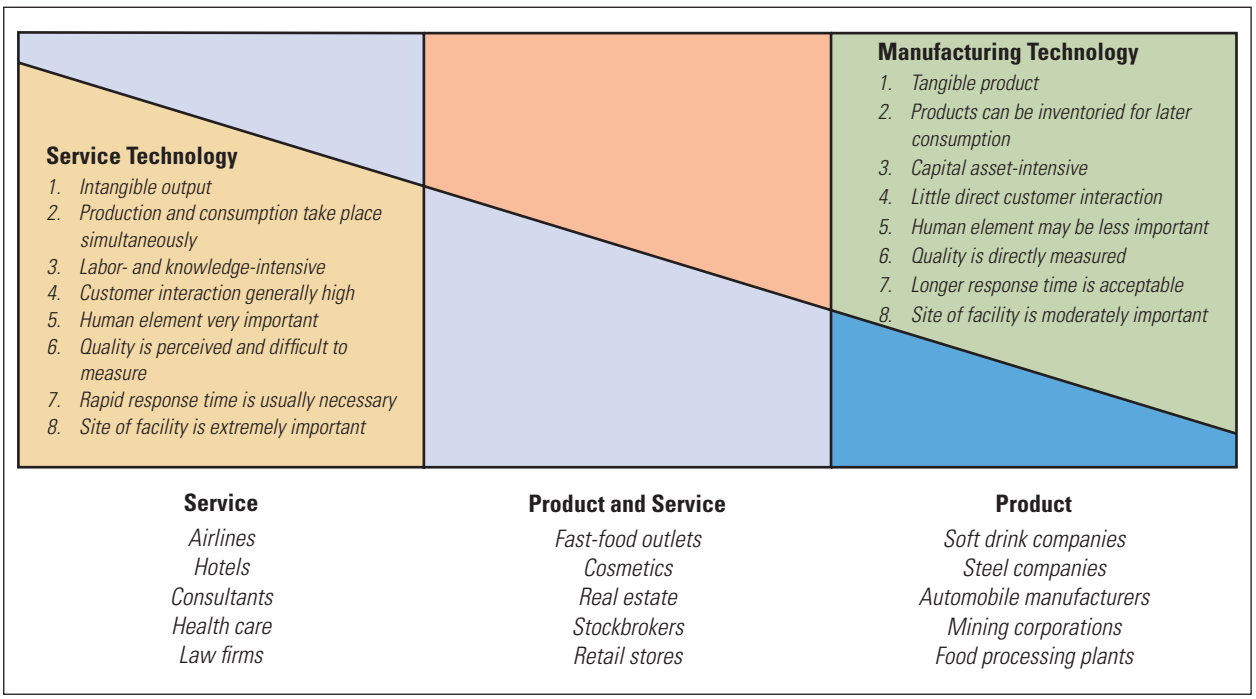
Definition. Whereas manufacturing organizations achieve their primary purpose through the production of products, service organizations accomplish their primary purpose through the production and provision of services, such as education, healthcare, social networking, transportation, entertainment, banking, and tourism. Studies of service organizations have focused on the unique dimensions of service technologies. The characteristics of **service technology** are compared to those of manufacturing technology in Exhibit 8.8.

The most obvious difference is that service technology produces an *intangible output*, such as social networking provided by Facebook, rather than a tangible product, such as a refrigerator produced by General Electric. A service is abstract and often consists of knowledge and ideas rather than a physical product. Thus, whereas manufacturers' products can be inventoried for later sale, services are characterized by *simultaneous production and consumption*. A client meets with a doctor or attorney, for example, and students and teachers come together in the classroom or over the Internet. A service is an intangible product that does not exist until it is requested by the customer. It cannot be stored, inventoried, or viewed as a finished good. If a service is not consumed immediately upon production, it disappears.[57] This typically means that service firms are *labor and knowledge intensive*, with many employees needed to meet the needs of customers, whereas manufacturing firms tend to be *capital intensive*, relying on mass production, continuous process, and smart manufacturing technologies.[58]

Direct interaction between customer and employee is generally very high with services, while there is little direct interaction between customers and employees in the technical core of a manufacturing firm. This direct interaction means that the *human element* (employees) becomes extremely important in service firms. Whereas most people never meet the workers who manufactured their cars, they

EXHIBIT 8.8

Differences Between Manufacturing and Service Technologies



Sources: Based on F. F. Reichheld and W. E. Sasser, Jr., "Zero Defections: Quality Comes to Services," *Harvard Business Review* 68 (September–October 1990), 105–111; and David E. Bowen, Caren Siehl, and Benjamin Schneider, "A Framework for Analyzing Customer Service Orientations in Manufacturing," *Academy of Management Review* 14 (1989), 75–95.

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often interact directly with the salesperson who sells them a new truck, or the Avis associate who rents them a car while on vacation. The treatment received from the salesperson—or from a doctor, lawyer, or hairstylist—affects the perception of the service received and the customer's level of satisfaction. The *quality of a service is perceived* and cannot be directly measured and compared in the same way that the quality of a tangible product can. Another characteristic that affects customer satisfaction and perception of quality service is *rapid response time*. A service must be provided when the customer wants and needs it. When you take a friend to dinner, you want to be seated and served in a timely manner; you would not be very satisfied if the hostess or manager told you to come back tomorrow when there would be more tables or servers available to accommodate you.

The final defining characteristic of service technology is that *site selection is often much more important* here than with manufacturing. Because services are intangible, they have to be located where the customer wants to be served. Services are dispersed and located geographically close to customers. For example, fast-food franchises usually disperse their facilities into local stores. Most towns of even moderate size today have two or more McDonald's restaurants rather than one large one, for example, in order to provide service where customers want and need it.

In reality, it is difficult to find organizations that reflect 100 percent service or 100 percent manufacturing characteristics. Some service firms take on characteristics of manufacturers, and vice versa. Many manufacturing firms are placing a greater emphasis on customer service to differentiate themselves and be more competitive. In addition, manufacturing organizations have departments such as purchasing, human resources, and marketing that are based on service technology. On the other hand, organizations such as gas stations, stockbrokers, retail stores, and restaurants belong to the service sector, but the provision of a product is a significant part of the transaction. The vast majority of organizations involve some combination of products and services. The important point is that all organizations can be classified along a continuum that includes both manufacturing and service characteristics, as illustrated in Exhibit 8.8. This chapter's "How Do You Fit the Design?" questionnaire will give you some insight into whether you are better suited to be a manager in a service organization or a manufacturing firm.

HOW DO YOU FIT THE DESIGN?

MANUFACTURING VERSUS SERVICE

The questions that follow ask you to describe your behavior. For each question, check the answer that best describes you.

1. I am usually running late for class or other appointments:
   - **a.** Yes
   - **b.** No
2. When taking a test I prefer:
   - **a.** Subjective questions (discussion or essay)
   - **b.** Objective questions (multiple choice)
3. When making decisions, I typically:
   - **a.** Go with my gut—what feels right
   - **b.** Carefully weigh each option
4. When solving a problem, I would more likely:
   - **a.** Take a walk, mull things over, and then discuss
   - **b.** Write down alternatives, prioritize them, and then pick the best
5. I consider time spent daydreaming as:
   - **a.** A viable tool for planning my future
   - **b.** A waste of time

(continued)

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6. To remember directions, I typically:
   a. Visualize the information
   b. Make notes
7. My work style is mostly:
   a. Juggle several things at once
   b. Concentrate on one task at a time until complete
8. My desk, work area, and laundry area are typically:
   a. Cluttered
   b. Neat and organized

Scoring: Count the number of checked "a" items and "b" items. Each "a" represents right-brain processing, and each "b" represents left-brain processing. If you scored 6 or higher on either, you have a distinct processing style. If you checked fewer than 6 for either, you probably have a balanced style.

Interpretation: People have two thinking processes—one visual and intuitive in the right half of the brain, and the other verbal and analytical in the left half of the brain. The thinking process you prefer predisposes you to certain types of knowledge and information—technical reports, analytical information, and quantitative data (left brain) versus talking to people, thematic impressions, and personal intuition (right brain)—as effective input to your thinking and decision making. Manufacturing organizations typically use left-brain processing to handle data based on physical, measurable technology. Service organizations typically use right-brain processing to interpret less tangible situations and serve people in a direct way. Left-brain processing has been summarized as based on logic; right-brain processing has been summarized as based on love.

Source: Adapted from Carolyn Hopper, *Practicing Management Skills* (Houghton Mifflin, 2003); and Jacquelyn Wonder and Priscilla Donovan, "Mind Openers," *Self* (March 1984).

The Trend Toward Customized Services. Service firms have always tended toward providing *customized output*—that is, providing exactly the service each customer wants and needs. When you visit a hairstylist, you don't automatically get the same cut the stylist gave the three previous clients. The stylist cuts your hair the way you request it. Pandora.com, whose mission is "to play only music you love," provides its registered users with a custom radio channel that broadcasts a set of music that fits their preferences.[59]

Customer expectations of what constitutes good service are rising. Companies such as Nordstrom and Zappos.com provide free shipping on both orders and returns. Amazon.com not only aims to have the lowest price and the fastest delivery, but it also helps outside retailers bring their customer service up to par and covers for their service shortcomings if they don't. Insurance and financial services giant USAA cross-trained its agents and call center representatives so that customers can get answers to their questions about any product or service rather than being switched around from one agent to another.[60] At Montefiore Medical Center in the Bronx, New York, rather than having specialized medical, surgical, cardiothoracic, and neurosurgical intensive care units (ICUs), Dr. Vladimir Kvetan combined them into a central critical-care department to increase efficiency and improve patient care. Kvetan, director of critical-care medicine, is continually thinking of ways to provide better care more efficiently, which means Montefiore rarely encounters the critical-care bottlenecks that many other large hospitals experience.[61]

The expectation for better service is pushing service firms in industries from food service to package delivery to take a lesson from manufacturing.[62] Japan Post, under pressure to cut a $191 million loss on operations, hired Toyota's Toshihiro Takahashi to help apply the principles of the Toyota Production System to the collection, sorting, and delivery of mail. In all, Takahashi's team came up with 370 improvements and reduced the post office's person-hours by 20 percent. The waste reduction is expected to cut costs by around $350 million a year.[63] Numerous other service firms, in the United States as well as in other countries, have also

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applied ideas from manufacturing in recent years. UPS installed a bigger, more automated network that can handle 350,000 more packages per hour to manage the 800 million packages it delivers between Thanksgiving and Christmas each year.[64] Panera Bread Company also applied new technology to improve customer service.

IN PRACTICE

Panera Bread Company

When managers at Panera Bread investigated declining sales and profits, they learned that it wasn't the quality of the food that was causing the problem. People were just having to wait in line too darn long. In addition, ten percent of the orders were wrong when they did come out. Co-founder and former CEO Ron Shaich said customers were having to stand in a "mosh pit" of people for up to eight minutes just to place an order.

Panera's leaders decided to rethink the service model and spent six years perfecting their online ordering process. Today, digital ordering makes up more than a quarter of sales for the company. Many Panera cafes have also added self-order kiosks inside the store. The average time a customer waits in line to order has shrunk from eight minutes to one. However, the transition wasn't totally smooth. Digital ordering increased volume and led to more customization of orders, meaning kitchen employees and other staff had a hard time keeping up. Revising workflow procedures and simplifying kitchen display systems helped to solve the problem. "It was literally hundreds of these little things that we did," said Blaine Hurst, who recently retired as CEO. Customers like Catherine Rinehart appreciate the change. "It saves me from . . . taking half my lunch hour to get the food," said the marketing executive.[65]

Another good example comes from Seattle Children's Hospital, which applied lessons from manufacturing to increase efficiency and improve patient care. Administrators implemented a program called "Continuous Performance Improvement" (CPI). CPI examines every aspect of patients' experience from the time they arrive in the parking lot until they are discharged. Managers involved all hospital staff in studying the flow of medicines, patients, and information in the same way plant managers study the flow of materials in a manufacturing plant and asked them to find ways to improve processes. Patients often had to wait for a non-emergency MRI for nearly a month. Now, that wait time has been cut to one or two days thanks to more efficient scheduling. Standardizing the instrument cart for specific types of surgeries cut inventory costs and reduced instrument preparation errors. Overall, the CPI program helped cut costs per patient by 3.7 percent, for savings of $23 million. The hospital has also been able to serve thousands more patients without expanding or adding beds. [66]

With the costs of medical care soaring, other healthcare organizations are also taking a continuous improvement approach to cutting costs without sacrificing quality of care. "In healthcare, you can't do one big thing and reduce the price," says Dr. Devi Shetty, who runs a hospital in India that performs open-heart surgery for about 10 percent of the cost charged by hospitals in the United States "We have to do 1,000 small things."[67]

8.3b Designing the Service Organization

The feature of service technologies with a distinct influence on organizational structure and control systems is the need for technical core employees to be close to the customer.[68] The differences between service and product organizations necessitated by customer contact are summarized in Exhibit 8.9.

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EXHIBIT 8.9
Configuration and Structural Characteristics of Service Organizations Versus Product Organizations

	Service	Product
Structural Characteristic		
1. Separate boundary roles	Few	Many
2. Geographical dispersion	Much	Little
3. Decision making	Decentralized	Centralized
4. Formalization	Lower	Higher
Human Resources		
1. Employee skill level	Higher	Lower
2. Skill emphasis	Interpersonal	Technical

The impact of customer contact on organization design is reflected in the use of boundary roles and structural disaggregation.[69] Boundary roles are used extensively in manufacturing firms to handle customers and to reduce disruptions for the technical core. They are used less in service firms because a service is intangible and cannot be passed along by boundary spanners, so service customers must interact directly with technical employees, such as doctors or brokers.

A service firm deals in information and intangible outputs and does not need to be large. Its greatest economies are achieved through disaggregation into small units that can be located close to customers. Stockbrokers, doctors' clinics, consulting firms, and banks disperse their facilities into regional and local offices. Manufacturing firms, on the other hand, tend to aggregate operations in a single area that has raw materials and an available workforce. A large manufacturing firm can take advantage of economies derived from expensive machinery and long production runs.

Service technology also influences internal organization characteristics used to direct and control the organization. For one thing, the skills of technical core employees typically need to be higher. These employees need enough knowledge and awareness to handle customer problems rather than just enough to perform mechanical tasks. Employees need social and interpersonal skills as well as technical skills.[70] Because of higher skills and structural dispersion, decision making often tends to be decentralized in service firms, and formalization tends to be low. Although some service organizations, such as many fast-food chains, have set rules and procedures for customer service, employees in service organizations typically have more freedom and discretion on the job. Managers at Home Depot have learned that how employees are managed has a great deal to do with the success of a service organization.

IN PRACTICE

Home Depot Inc.

Home Depot grew to be the world's largest home improvement retailer largely on the strength of its employees. Many people hired to work in the stores were former plumbers, carpenters, or other skilled tradesmen who understood the products and took pride in helping do-it-yourself customers find the right tools and supplies and know how to use them.

To cut costs, however, the company began hiring more part-time employees and instituted a salary cap that made jobs less appealing to experienced workers. As a further way to reduce costs, managers began measuring every aspect of the stores' productivity, such as how long it took to unload shipments of goods or how many extended warranties each employee sold per week. Customers began complaining that they could never find anyone to assist them—and even when they did, many employees didn't have the knowledge and experience to be of much help. Some customers took their business elsewhere, even if it meant going to small shops where they would pay higher prices but get better service.

Home Depot managers have been working hard to get things back on track. The stores are hiring more full-timers again, instituting new training programs, and looking for other ways to make sure service employees are knowledgeable and helpful.[71]

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Managers at Home Depot can use an understanding of the nature of service technology to help them align strategy, structure, and management processes and make the retailer more effective. Service technologies require structures and systems that are quite different from those for a traditional manufacturing technology. For example, the concept of separating complex tasks into a series of small jobs and exploiting economies of scale is a cornerstone of traditional manufacturing, but researchers have found that applying it to service organizations often does not work so well.[72] Some service firms have redesigned jobs to separate low- and high-customer-contact activities, with more rules and standardization in the low-contact jobs. High-touch service jobs, like those on the Home Depot sales floor, need more freedom and less control to satisfy customers.

2 The best way for a company to provide good service is to have abundant and clear rules and procedures and make sure everyone follows them to the letter.

ASSESS YOUR ANSWER

ANSWER: *Disagree.* Service employees need good interpersonal skills and a degree of autonomy to be able to satisfy each customer's specific needs. Although many service organizations have some standard procedures for serving customers, service firms are typically low on both centralization and formalization. Abundant rules can take away both personal autonomy and the personal touch.

REMEMBER THIS

- Service technologies differ in a systematic way from manufacturing technologies and thus require a different approach to organization design.
- Service technologies are characterized by intangible outcomes, simultaneous production and consumption, and direct interaction between customer and employee, which means the human element of the organization (employees) becomes extremely important.
- Most organizations involve a combination of products and services and can be classified along a continuum that includes both manufacturing and service characteristics.

8.4 Noncore Departmental Technology

This section shifts to the department level of analysis for departments not within the technical core. Departments often have characteristics similar to those of service technology, providing services to other departments within the organization. For example, refer back to Exhibit 8.1, which illustrates human resources, accounting, research and development, and marketing departments that are outside of the technical core. Each of these (and other noncore) departments in an organization has its own production process that consists of a distinct technology. A company such as Tenneco, a large maker of auto parts, might have departments for engineering, research and development, human resources, marketing, quality control, finance, and dozens of other functions. This section analyzes the nature of departmental technology and its relationship with departmental design.

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The framework that has had the greatest impact on the understanding of departmental technologies was developed by Charles Perrow.[73] Perrow's model has been useful for a broad range of technologies, which made it ideal for research into departmental activities.

8.4a Variety

Perrow specified two dimensions of departmental activities that were relevant to organization structure and processes. The first is the number of exceptions in the work. This refers to task **variety**, which is the frequency of unexpected and novel events that occur in the conversion process. Task variety concerns whether work activities are performed the same way every time or differ from time to time as employees transform the organization's inputs into outputs.[74] When individuals encounter a large number of unexpected situations, with frequent problems, variety is considered high. When there are few problems, and when day-to-day job requirements are repetitious, technology contains little variety. Variety in departments can range from repeating a single act, such as on a traditional assembly line, to working on a series of unrelated problems, such as in a hospital emergency room.

8.4b Analyzability

The second dimension of technology concerns the **analyzability** of work activities. When the conversion process is analyzable, the work can be reduced to mechanical steps and participants can follow an objective, computational procedure to solve problems. Problem solution may involve the use of standard procedures, such as instructions and manuals, or technical knowledge, such as that in a textbook or handbook. On the other hand, some work is not analyzable. When problems arise, it is difficult to identify the correct solution. There is no store of techniques or procedures to tell a person exactly what to do. The cause of or solution to a problem is not clear, so employees rely on accumulated experience, intuition, and judgment. The final solution to a problem is often the result of wisdom and experience and not the result of standard procedures. For example, Philippos Poulos, a tone regulator at Steinway & Sons, has an unanalyzable technology. Tone regulators carefully check each piano's hammers to ensure that they produce the proper "Steinway sound."[75] These quality-control tasks require years of experience and practice. Standard procedures will not tell a person how to do such tasks.

8.4c Framework

The two dimensions of departmental technology and examples of departmental activities that would fit on Perrow's framework are shown in Exhibit 8.10. The dimensions of variety and analyzability form the basis for four major categories of technology: routine, craft, engineering, and nonroutine.

Categories of Departmental Technology. **Routine technologies** are characterized by little task variety and the use of objective, computational procedures. The tasks are formalized and standardized. Examples include an automobile assembly line and a bank teller department.

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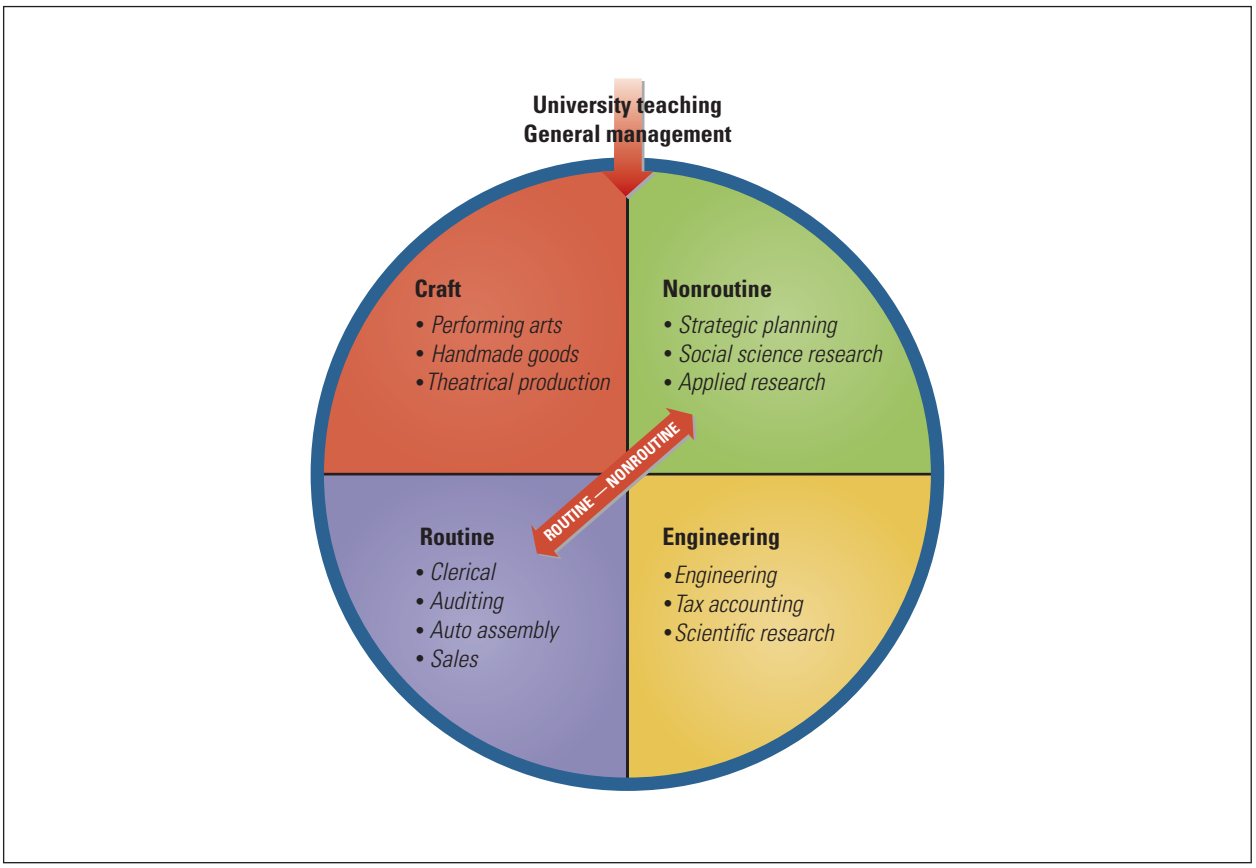
Craft technologies are characterized by a fairly stable stream of activities, but the conversion process is not analyzable or well understood. Tasks require extensive training and experience because employees respond to intangible factors on the basis of wisdom, intuition, and experience. Although advances in machine technologies seem to have reduced the number of craft technologies in organizations, craft technologies are still important. For example, steel furnace engineers continue to mix steel based on intuition and experience, pattern makers at fashion houses such as Louis Vuitton, Zara, or H&M convert rough designers' sketches into saleable garments, and teams of writers for television series such as *Game of Thrones* or *This Is Us* convert ideas into story lines.

Engineering technologies tend to be complex because there is substantial variety in the tasks performed. However, the various activities are usually handled on the basis of established formulas, procedures, and techniques. Employees normally refer to a well-developed body of knowledge to handle problems. Engineering and accounting tasks usually fall in this category.

Nonroutine technologies have high task variety, and the conversion process is not analyzable or well understood. In nonroutine technology, a great deal of effort is devoted to analyzing problems and activities. Several equally acceptable options

EXHIBIT 8.10
Framework for Department Technologies



Sources: Based on R. L. Daft and N. Macintosh, "A New Approach to the Design and Use of Management Information," *California Management Review* 20 (August 1978), 82–92; R. L. Daft and N. Macintosh, "The Technology of User Departments and Information Design," *Information and Management* l (April 1978), 122–131; and R. L. Daft and N. Macintosh, "A Tentative Exploration into the Amount and Equivocality of Information Processing in Organizational Work Units," *Administrative Science Quarterly* 26 (June 1981), 207–224.

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typically can be found. Experience and technical knowledge are used to solve problems and perform the work. Basic research, strategic planning, and other work that involves new projects and unexpected problems are nonroutine. The biotechnology industry also represents a nonroutine technology. Breakthroughs in understanding metabolism and physiology at a cellular level depend on highly trained employees who use their experience and intuition, as well as scientific knowledge.[76]

Routine Versus Nonroutine. Variety and analyzability can be combined into a single dimension of technology. This dimension is called *routine versus nonroutine technology*. The analyzability and variety dimensions are often correlated in departments, meaning that technologies high in variety tend to be low in analyzability, and technologies low in variety tend to be analyzable. Departments can be evaluated along a single dimension of routine versus nonroutine, as illustrated in Exhibit 8.10, that combines both analyzability and variety, which is a useful shorthand measure for analyzing departmental technology.[77]

The following questions show how departmental technology can be analyzed for determining its placement on Perrow's technology framework in Exhibit 8.10.[78] Employees normally circle a number from 1 to 7 in response to each question.

Variety:

1. To what extent would you say your work is routine?
2. Does almost everyone in this unit do about the same job in the same way most of the time?
3. Are unit members performing repetitive activities in doing their jobs?

Analyzability:

1. To what extent is there a clearly known way to do the major types of work you normally encounter?
2. To what extent is there an understandable sequence of steps that can be followed in doing your work?
3. To do your work, to what extent can you actually rely on established procedures and practices?

If answers to the preceding questions indicate high scores for analyzability and low scores for variety, the department would have a routine technology. If the opposite occurs, the technology would be nonroutine. Low variety and low analyzability indicate a craft technology, and high variety and high analyzability indicate an engineering technology. As a practical matter, most departments fit somewhere along the diagonal and can be most easily characterized as routine or nonroutine.

8.4d Department Design

Once the nature of a department's technology has been identified, the appropriate design can be determined. Department technology tends to be associated with a cluster of departmental characteristics, such as the skill level of employees, formalization, and methods of communication. Definite patterns exist in the relationship between work unit technology and design characteristics, which are associated with departmental performance.[79] Key relationships between technology and other dimensions of departments are described in this section and are summarized in Exhibit 8.11.

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The overall design of departments may be characterized as either organic or mechanistic. Routine technologies are associated with a mechanistic design, with formal rules and rigid management processes. Nonroutine technologies are associated with an organic design, and department management is more flexible and free-flowing. For example, consider the organization of departments that provide food to hospital patients.

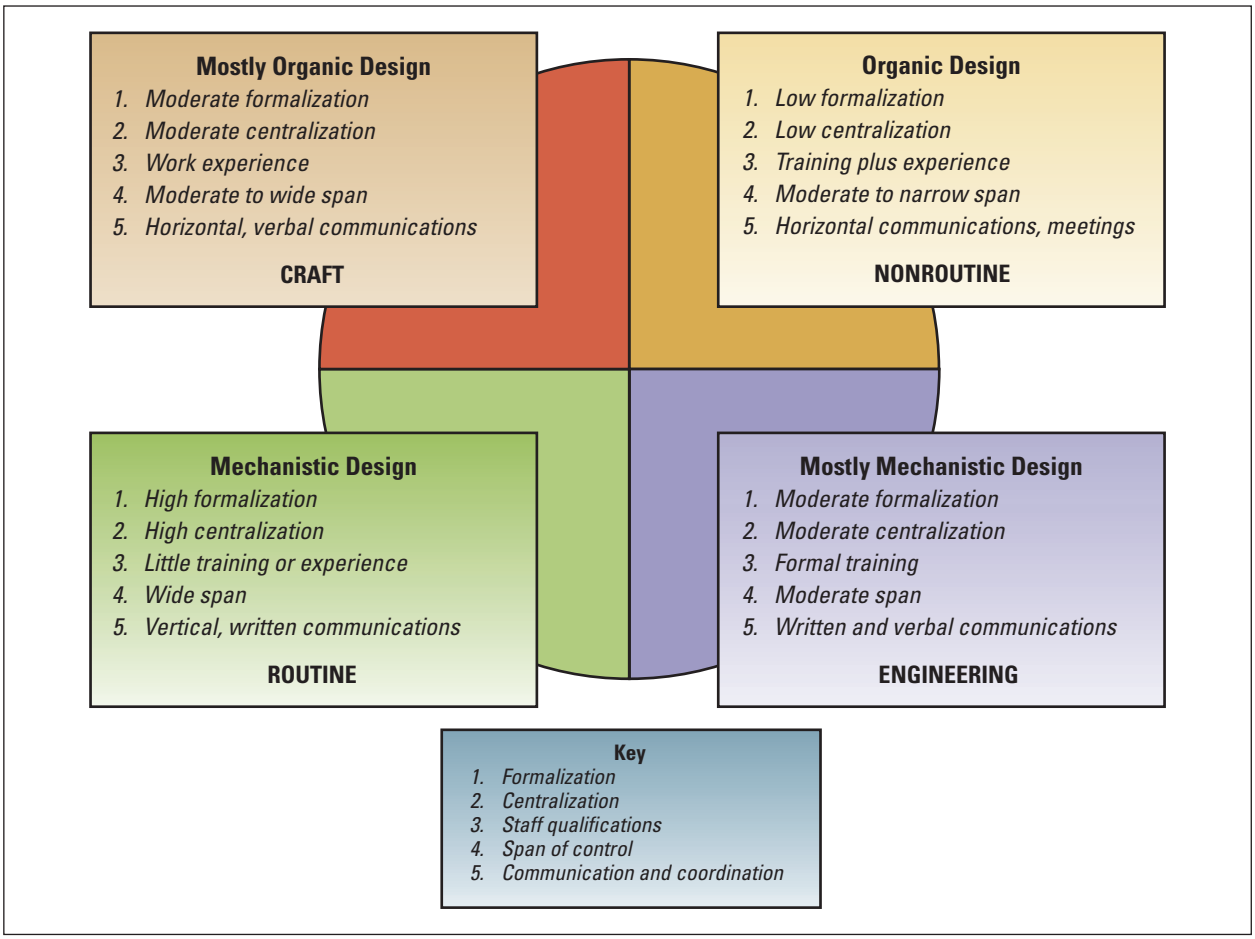
IN PRACTICE

Memorial Sloan-Kettering Cancer Center

For many years, hospital food service units reflected a routine technology. Workers followed a standard menu, prepared meals according to standard recipes, and followed standard rules and procedures. In recent years, some hospitals have shifted to a nonroutine approach.

Pnina Peled, head chef at Memorial Sloan-Kettering Cancer Center, recently made her first lemon-flavored pizza. Peled is always thinking of new ways to get patients to eat. A teenage patient wanted pizza but could only taste lemon, so Peled created a pizza with a lemon Alfredo sauce. At Memorial Sloan-Kettering, patients "now order what they want to eat, when they are ready to eat," says Veronica McLymont, director of food and nutrition services. That means less food waste, but it also means kitchen staff have to be better trained, more experienced, and more flexible, and people need more discretion in their behavior to provide personalized food service. Hospitals such as Memorial Sloan-Kettering, Rex Healthcare in Raleigh, North Carolina, MD Anderson Cancer Center in Houston, and Brigham and Women's Hospital in Boston are retraining kitchen staff, giving them more flexibility in line with a nonroutine service technology.[80]

EXHIBIT 8.11
Relationship of Department Technology to Structural and Management Characteristics



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As an organization manager, keep these guidelines in mind:

Use the two dimensions of variety and analyzability to discover whether the work in a department is routine or nonroutine. If the work in a department is routine, use a mechanistic design, with a rigid structure and processes. If the work in a department is nonroutine, use an organic design and flexible management processes.

The specific design characteristics of formalization, centralization, employee skill level, span of control, and communication and coordination vary, depending on work unit technology, as illustrated in Exhibit 8.11.

1. *Formalization.* Routine technology is characterized by standardization and division of labor into small tasks that are governed by formal rules and procedures. For nonroutine tasks, the structure is less formal and less standardized. When variety is high, as in a research department, fewer activities are covered by formal procedures.[81]
2. *Decentralization.* In routine technologies, most decision making about task activities is centralized to management.[82] In engineering technologies, employees with technical training tend to acquire moderate decision authority because technical knowledge is important to task accomplishment. Production employees who have years of experience obtain decision authority in craft technologies because they know how to respond to problems. Decentralization to employees is greatest in nonroutine settings, where many decisions are made by employees.
3. *Employee skill level.* Work staff in routine technologies typically require little education or experience, which is congruent with repetitious work activities. In work units with greater variety, staff members are more skilled and often have formal training in technical schools or universities. Training for craft activities, which are less analyzable, is more likely to be through job experience. Nonroutine activities require both formal education and job experience.[83]
4. *Span of control.* Span of control is the number of employees who report to a single manager or supervisor. This characteristic is normally influenced by departmental technology. The more complex and nonroutine the task, the more problems arise in which the supervisor becomes involved. Although the span of control may be influenced by other factors, such as skill level of employees, it typically should be smaller for complex tasks because on such tasks the supervisor and subordinate must interact frequently.[84]
5. *Communication and coordination.* Communication activity and frequency increase as task variety increases.[85] Frequent problems require more information sharing to solve problems and ensure proper completion of activities. The direction of communication is typically horizontal in nonroutine work units and vertical in routine work units.[86] The form of communication varies by task analyzability.[87] When tasks are highly analyzable, statistical and written forms of communication (e.g., memos, reports, rules, and procedures) are frequent. When tasks are less analyzable, information typically is conveyed face to face, over the telephone, or in group meetings.

Two important points are reflected in Exhibit 8.11. First, departments differ from one another and can be categorized according to their workflow technology.[88] Second, structural and management processes differ based on departmental technology. Managers should design their departments so that requirements based on technology can be met. Design problems are most visible when the design is clearly inconsistent with technology. Studies have found that when structure and communication characteristics did not reflect technology, departments tended to be less effective.[89] Employees could not communicate with the frequency needed to solve problems.

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3 The design characteristics and management processes that are effective for a television station's sales department probably would not work so well for the news department.

ASSESS YOUR ANSWER

ANSWER: *Agree.* The news department has a nonroutine technology compared to the sales department. No one knows what newsworthy events are going to happen during the day, when or where they will happen, or how they will need to be covered. Sales tasks, particularly telephone sales to repeat customers involving standard rates for advertising, can be performed using standard procedures, but gathering and reporting news events can't be standardized. A sales department would be characterized as routine because there is little variety and tasks are well understood.

REMEMBER THIS

- One framework that helps explain the appropriate design for departmental technologies was developed by Charles Perrow.
- A manager can identify the management style, structure, and process that should characterize a department by understanding the variety and analyzability of a department technology.
- Routine technologies are associated with a mechanistic design, with formal rules and rigid management processes. Nonroutine technologies are associated with an organic design, and department management is more flexible.
- Applying the wrong structure and management system to a department will result in employee dissatisfaction and reduced efficiency and effectiveness.

8.5 Workflow Interdependence Among Departments

The final characteristic of technology that influences organization design is called interdependence. **Interdependence** means the extent to which departments depend on each other for information, resources, or materials to accomplish their tasks. Low interdependence means that departments can do their work independently of each other and have little need for interaction, consultation, or exchange of materials. High interdependence means departments must constantly exchange resources.

8.5a Types

James Thompson defined three types of interdependence that influence organization structure.[90] These interdependencies are illustrated in Exhibit 8.12 and are discussed in the following sections.

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As an organization manager, keep these guidelines in mind:

Evaluate the interdependencies among organizational departments. Use the general rule that, as interdependencies increase, mechanisms for coordination must also increase. Consider a divisional structure for pooled interdependence. For sequential interdependence, use task forces and integrators for greater horizontal coordination. At the highest level of interdependence (reciprocal interdependence), support relational coordination and consider a holacracy team structure.

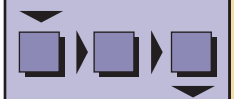
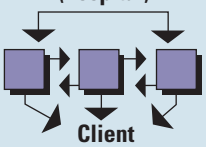
Pooled. **Pooled interdependence** is the lowest form of interdependence among departments. In this form, work does not flow between units. Each department is part of the organization and contributes to the common good of the organization but works independently. Subway restaurants or Bank of America branches are examples of pooled interdependence. An outlet in Chicago need not interact with an outlet in Urbana. Pooled interdependence may be associated with the relationships within a *divisional structure*, defined in Chapter 3. Divisions or branches share financial resources from a common pool, and the success of each division contributes to the success of the overall organization.

Thompson proposed that pooled interdependence would exist in firms with what he called a mediating technology. A **mediating technology** provides products or services that mediate or link clients from the external environment and, in so doing, allows each department to work independently. Banks, brokerage firms, and real estate offices all mediate between buyers and sellers, but the offices work independently within the organization.

The management implications associated with pooled interdependence are quite simple. Thompson argued that managers should use rules and procedures to standardize activities across departments. Each department should use the same procedures and financial statements so the outcomes of all departments can be measured and pooled. Very little day-to-day coordination is required among units.

Sequential. When interdependence is of serial form, with parts produced in one department becoming inputs to another department, it is called **sequential interdependence**. The first department must perform correctly for the second department to

EXHIBIT 8.12
Thompson's Classification of Interdependence and Management Implications

Form of Interdependence	Demands on Horizontal Communication, Decision Making	Type of Coordination Required	Priority for Locating Units Close Together
Pooled (bank) Clients	Low communication	Standardization, rules, procedures Divisional structure	Low
Sequential (assembly line)  Client	Medium communication	Plans, schedules, feedback Task forces	Medium
Reciprocal (hospital)  Client	High communication	Mutual adjustment, relational coordination, teamwork Horizontal structure	High

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perform correctly. This is a higher level of interdependence than pooled interdependence because departments exchange resources and depend on others to perform well. Sequential interdependence creates a greater need for horizontal mechanisms such as integrators or task forces.

Sequential interdependence occurs in what Thompson called **long-linked technology**, which "refers to the combination in one organization of successive stages of production; each stage of production uses as its inputs the production of the preceding stage and produces inputs for the following stage."[91] An example of sequential interdependence comes from the shipbuilding industry. Until recently, ship designers made patterns and molds out of paper and plywood, which were passed on to assembly. The cutting department depended on accurate measurements from the designers, and the assembly department depended on accurate parts from the cutting department. This sequential interdependence meant that mistakes in measurements or pattern mix-ups often caused errors in the cutting and assembly process, leading to delays and increased costs. Naval architect Filippo Cali created a complex software program that computerizes the process of making patterns and molds, thus eliminating many of the problems between design and assembly.[92] Another example of sequential interdependence would be an automobile assembly line, which must have all the parts it needs to keep production rolling, such as engines, steering mechanisms, and tires.

The management requirements for sequential interdependence are more demanding than those for pooled interdependence. Coordination among the linked plants or departments is required. Since the interdependence implies a one-way flow of materials, extensive planning and scheduling are generally needed. Department B needs to know what to expect from Department A so both can perform effectively. Some day-to-day communication among plants or departments is also needed to handle unexpected problems and exceptions that arise.

Reciprocal. The highest level of interdependence is **reciprocal interdependence**. This exists when the output of operation A is the input to operation B, and the output of operation B is the input back again to operation A. The outputs of departments influence those departments in reciprocal fashion.

Reciprocal interdependence tends to occur in organizations with what Thompson called **intensive technologies**, which provide a variety of products or services in combination to a client. A firm developing new products provides an example of reciprocal interdependence. Intense coordination is needed between design, engineering, manufacturing, and marketing to combine all their resources to suit the customer's product need. For example, Callaway Golf introduces seven to eight new products every year to keep its edge as one of the industry's most innovative manufacturers. Maintaining that pace requires tight coordination between design teams, engineers, marketing staff, and even lawyers. Teams have to communicate and quickly and securely share information created with CAD and CAM software with manufacturing partners in China, Japan, Korea, Mexico, and Taiwan. With the use of collaborative software, everyone involved in the process is able to access files 24 hours a day to keep track of the project. On a typical business day, 200 different users will access documents and collaborate with others.[93] Hospitals are also excellent examples of reciprocal interdependence because they provide coordinated services to patients.

Reciprocal interdependence requires that departments work together intimately and frequently. A study of top management teams confirms that the effective performance of teams characterized by high interdependence depends on

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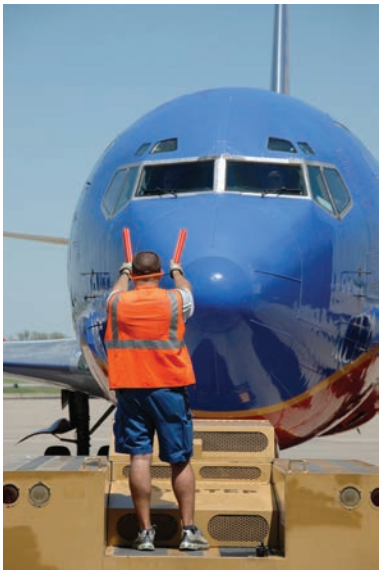
good communication and close coordination.[94] With reciprocal interdependence, the structure must allow for frequent horizontal communication and adjustment, perhaps using cross-functional teams or a holacracy team structure. Extensive planning is required, but plans will not anticipate or solve all problems. Daily interaction and mutual adjustment among departments are needed. People from several departments might need to be involved in face-to-face coordination, teamwork, and decision making. For these reasons, managers in organizations characterized by reciprocal interdependence often organize work in such a way to encourage and support *relational coordination*, as described in Chapter 3, so that people share information and coordinate across departments as a normal part of their everyday work lives. Coordination and information sharing are built into the fabric of the organization.[95] Southwest Airlines, also described in Chapter 3, provides a good example.

IN PRACTICE

Southwest Airlines



Carlos E. Santa Maria/Shutterstock.com

For all airlines, flight departure is a highly complex process that involves numerous employees from various departments, performing multiple tasks under uncertain and ever-changing conditions. Exhibit 8.13 illustrates the highly interdependent nature of the flight departure process, which involves ticket agents, pilots, flight attendants, baggage handlers, gate agents, operations agents, mechanics, cabin cleaners, ramp agents, cargo handlers, fuel attendants, and caterers. Tight coordination among these groups is essential for a successful on-time departure.

As described in Chapter 3, Southwest Airlines has the shortest turnaround time in the industry. How do they do it? Southwest managers promote relational coordination among all these interdependent groups, some of which are illustrated in Exhibit 8.13, to achieve superior on-time performance and a high level of customer satisfaction. A process called *team delay* helps people pinpoint problems in coordination between various groups rather than searching for who is to blame when something goes wrong. The emphasis on the team focuses everyone on shared goals of safety, on-time departure, accurate baggage handling, and customer satisfaction. Supervisors work closely with employees to facilitate learning and help people accomplish their jobs.

Southwest puts a lot of emphasis on hiring people with a collaborative attitude. Rather than focusing on technical skills, Southwest focuses on hiring people who are oriented toward teamwork. Training and development activities and organizational stories reinforce teamwork and mutual respect. One story is told that a pilot came for an interview at Southwest and treated an administrative assistant with disrespect. He didn't get the job. "We all succeed together—and all fail together," is the philosophy at Southwest, as one field manager put it.[96]

By using practices that support teamwork, shared goals, mutual respect, and shared responsibility and accountability, Southwest facilitates relational coordination so that interdependent departments are tightly coordinated. Reciprocal interdependence is the most complex interdependence for organizations to handle and the most challenging for managers in designing the organization.

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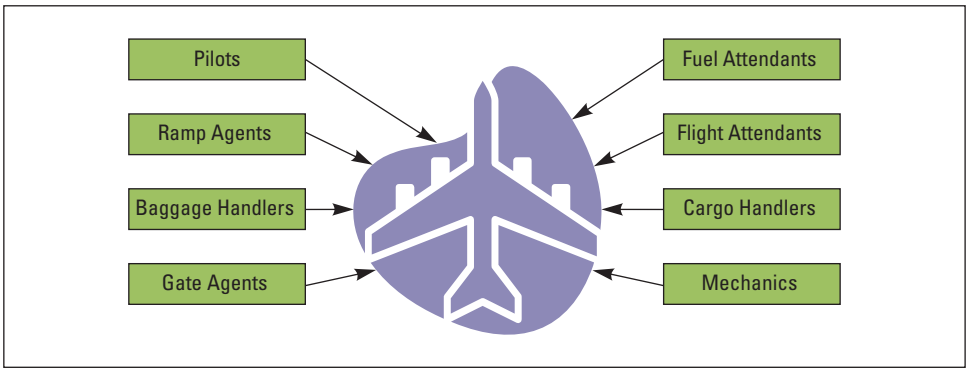

EXHIBIT 8.13
Interdependence of Departments Involved in the Flight Departure Process

Source: Based on Jody Hoffer Gittell, "Organizing Work to Support Relational Coordination," *International Journal of Human Resource Management* 11, no. 3 (June 2000), 517–539.

8.5b Structural Priority

As indicated in Exhibit 8.12, because decision making, communication, and coordination problems are greatest for reciprocal interdependence, reciprocal interdependence should receive first priority in organization structure. Activities that are reciprocally interdependent should be grouped close together in the organization so that managers have easy access to one another for mutual adjustment. These units should report to the same person on the organization chart and should be physically close so the time and effort for coordination can be minimized. For example, a holacracy team structure, with linked sets of teams working on core processes, could provide the close coordination needed to support reciprocal interdependence. Poor coordination will result in poor performance for the organization. If reciprocally interdependent units are not located close together, the organization should design mechanisms for coordination, such as relational coordination via daily meetings between departments or an intranet to facilitate communication. The next priority is given to sequential interdependencies, and finally to pooled interdependencies. This strategy of organizing keeps the communication channels short where coordination is most critical to organizational success.

8.5c Structural Implications

Most organizations experience various levels of interdependence, and structure can be designed to fit these needs, as illustrated in Exhibit 8.14.[97] In a manufacturing firm, new product development entails reciprocal interdependence among the design, engineering, purchasing, manufacturing, and sales departments. Perhaps cross-functional teams could be used to handle the back-and-forth flow of information and resources. Once a product is designed, its actual manufacture would be sequential-interdependent, with a flow of goods from one department to another, such as among purchasing, inventory, production control, manufacturing, and assembly. The actual ordering and delivery of products represents pooled-interdependence, with warehouses working independently. Customers could place an order with the nearest facility, which would not require coordination among warehouses, except in unusual cases such as a stock outage.

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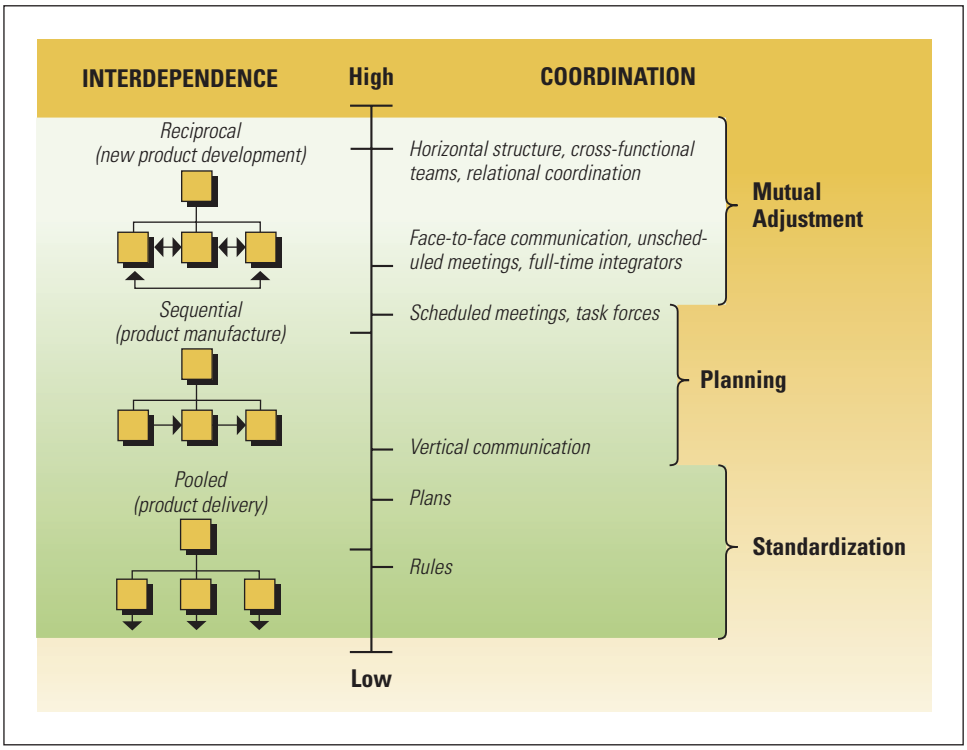
EXHIBIT 8.14
Primary Means to Achieve Coordination for Different Levels of Task Interdependence in a Manufacturing Firm



Source: Adapted from Andrew H. Van de Ven, Andre Delbecq, and Richard Koenig, "Determinants of Communication Modes within Organizations," *American Sociological Review* 41 (1976), 330.

The three levels of interdependence are illustrated by a study of athletic teams that examined interdependency among players and how it influences other aspects of baseball, football, and basketball teams.

IN PRACTICE

Athletic Teams

A major difference among baseball, football, and basketball is the interdependence among players. Baseball is low in interdependence, football is medium, and basketball represents the highest player interdependence. The relationships among interdependence and other characteristics of team play are illustrated in Exhibit 8.15.

Pete Rose said, "Baseball is a team game, but nine men who reach their individual goals make a nice team." In baseball, interdependence among team players is low and can be defined as pooled. Each member acts independently, taking a turn at bat and playing his or her own position. When interaction does occur, it is between only two or three players, as in a double play. Players are physically dispersed, and the rules of the game are the primary means of coordinating players. Players practice and develop their skills individually, such as by taking batting practice and undergoing physical conditioning. Management's job is to select good players. If each player is successful as an individual, the team should win.

In football, interdependence among players is higher and tends to be sequential. The line first blocks the opponents to enable the backs to run or pass. Plays are performed sequentially from first down to fourth down. Physical dispersion is medium, which allows players to operate as a coordinated unit. The primary mechanism for coordinating players is developing a game plan along with rules that govern the behavior of team members. Each player has an assignment that fits with other assignments, and management designs the game plan to achieve victory.

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In basketball, interdependence tends to be reciprocal. The game is free-flowing, and the division of labor is less precise than in other sports. Each player is involved in both offense and defense, handles the ball, and attempts to score. The ball flows back and forth among players. Team members interact in a dynamic flow to achieve victory. Management skills involve the ability to influence this dynamic process, either by substituting players or by working the ball into certain areas. Players must learn to adapt to the flow of the game and to one another as events unfold.

Interdependence among players is a primary factor explaining the difference among the three sports. Baseball is organized around an autonomous individual, football around groups that are sequentially interdependent, and basketball around the free flow of reciprocal players.[98]

	Baseball	Football	Basketball
Interdependence	Pooled	Sequential	Reciprocal
Physical dispersion of players	High	Medium	Low
Coordination	Rules that govern the sport	Game plan and position roles	Mutual adjustment and shared responsibility
Key management job	Select players and develop their skills	Prepare and execute game	Influence flow of game

EXHIBIT 8.15 Relationships Among Interdependence and Other Characteristics of Team Play

Source: Based on William Pasmore, Carol E. Francis, and Jeffrey Haldeman, "Sociotechnical Systems: A North American Reflection on the Empirical Studies of the 70s," *Human Relations* 35 (1982), 1179–1204.

REMEMBER THIS

- Interdependence among departments refers to the extent to which departments depend on each other for materials, information, or other resources. Interdependence determines the amount of coordination required between departments.
- Three types of interdependence are pooled, sequential, and reciprocal.
- As interdependence increases, demands on the organization for coordination increase. To be effective, organization design must allow for the correct amount of communication and coordination to handle interdependence across departments.

KEY CONCEPTS

analyzability
continuous process production
core technology
craft technologies
engineering technologies
high reliability organization (HRO)
intensive technologies
interdependence
large-batch production
long-linked technology
mass customization
mediating technology
noncore technology
nonroutine technologies
pooled interdependence
reciprocal interdependence
routine technologies
sequential interdependence
service technology
small-batch production
smart factories
technical complexity
technology
variety

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DISCUSSION QUESTIONS

1. Where would your university or college department be located on Perrow's technology framework? Should a department devoted exclusively to teaching be in a different quadrant from a department devoted exclusively to research?
2. What is the difference between "reluctance to simplify" and "sensitivity to operations" in a high reliability organization?
3. What is the level of interdependence among departments (finance, marketing) in a business school? What kinds of coordination mechanisms might be used to handle that interdependence?
4. Why does Woodward suggest that span of control needs to decrease as technological complexity increases? Can you think of any circumstances that might change the relationship between the two?
5. How do smart factories differ from other manufacturing technologies? How might the transformation to a smart factory change how a manufacturing organization hires and trains employees?
6. What is a service technology? Are different types of service technologies likely to be associated with different organization designs? Explain.
7. Why might administrators at a hospital such as Seattle Children's Hospital, described in this chapter, want to foster relational coordination?
8. A top executive claimed that top-level management is a craft technology because the work contains intangibles, such as handling personnel issues, interpreting an ambiguous environment, and coping with unusual situations. Do you agree? What type of structure or management process is appropriate for top-level managers?
9. Do you think the characteristics of a high reliability organization could be applied in non-HRO organizations? Explain.
10. To what extent does the development of new technologies simplify and routinize the jobs of employees? Can you give an example? Can new technology also lead to jobs with greater variety and complexity? Discuss.

CHAPTER 8 WORKSHOP Small Business Workflow Technology[99]

You will be analyzing the work technology used in two different small businesses—a local cleaners and a local family restaurant. Your instructor will tell you whether to do this assignment as individuals or in a group.

You must visit both organizations and infer how the work is done, according to the following criteria. You are not allowed to interview any employees, but instead you will be an observer. Take lots of notes when you are there.

	Cleaners	Family Restaurant
Organization goals: Speed, service, atmosphere, and so on.		
Type of technology using Woodward's model.		
Organization structure: Mechanistic or organic?		
Team versus individual: Do people work together or alone?		
Interdependence: How do employees depend on each other?		
Tasks: Routine versus nonroutine—how varied are tasks?		

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Questions

1. Do you think the technology used is the best one for each organization, considering your analysis in the table above?
2. From the table data, determine if the structure and other organization characteristics fit the workflow technology.
3. If you were part of a consulting team assigned to improve the operations of each organization, what recommendations would you make?

CASE FOR ANALYSIS | Acetate Department[100]

The acetate department's product consisted of about twenty different kinds of viscous liquid acetate used by another department to manufacture transparent film to be left clear or coated with photographic emulsion or iron oxide.

Before the change: The department was located in an old four-story building as in Exhibit 8.16. The workflow was as follows:

1. Twenty kinds of powder arrived daily in 50-pound paper bags. In addition, storage tanks of liquid would be filled weekly from tank trucks.
2. Two or three acetate helpers would jointly unload pallets of bags into the storage area using a lift truck.
3. Several times during a shift, the helpers would bring the bagged material up in the elevator to the third floor, where it would be temporarily stored along the walls.
4. Mixing batches was under the direction of the group leader and was rather like baking a cake. Following a prescribed formula, the group leader, mixers, and helpers operated valves to feed in the proper solvent and manually dump in the proper weight and mixture of solid material. The glob would be mixed by giant egg-beaters and heated according to the recipe.
5. When the batch was completed, it was pumped to a finished-product storage tank.
6. After completing each batch, the crew would thoroughly clean the work area of dust and empty bags, because cleanliness was extremely important to the finished product.

To accomplish this work, the department was structured as in Exhibit 8.17.

EXHIBIT 8.16

Elevation View of Acetate Department before Change

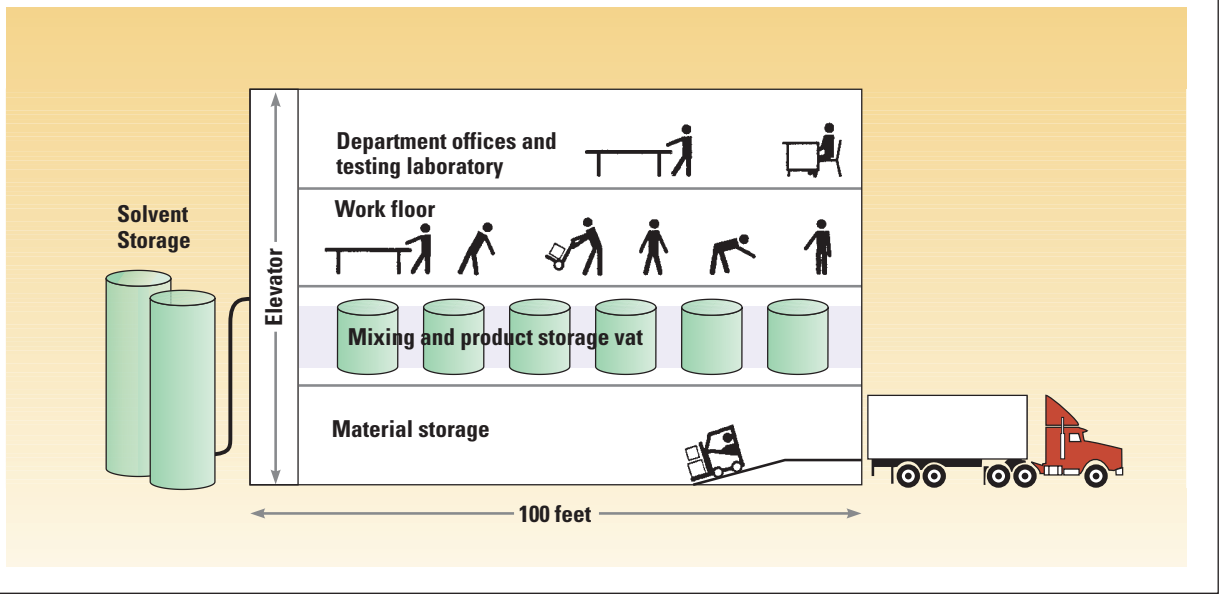

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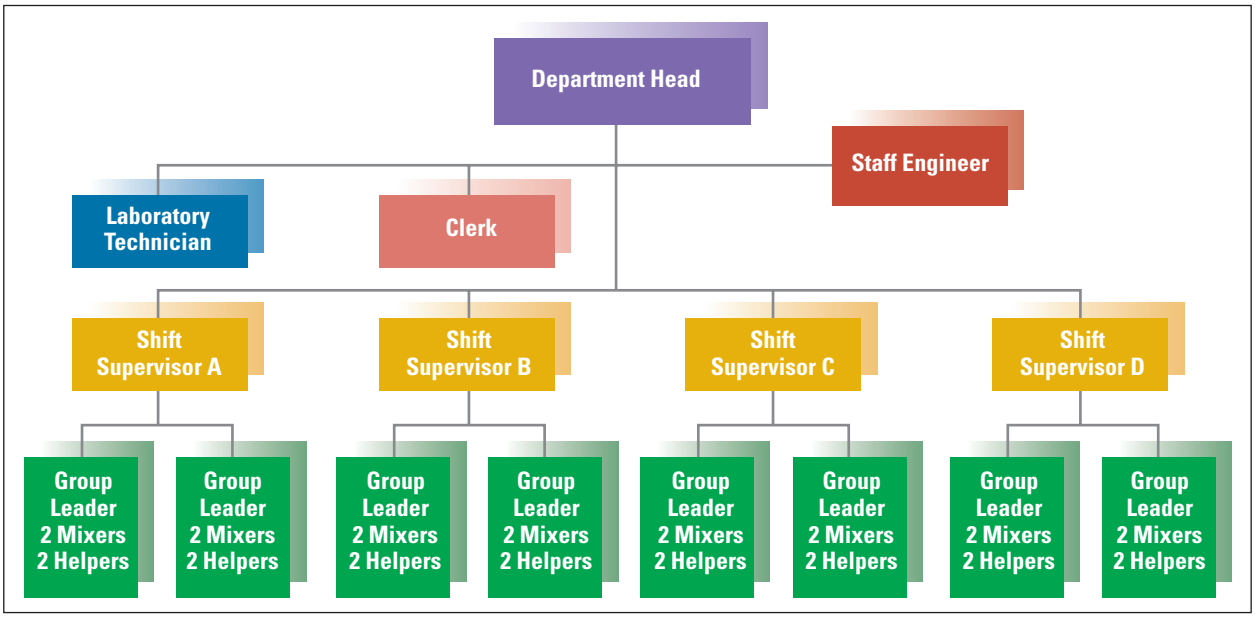
EXHIBIT 8.17
Organizational Chart of Acetate Department before Change


Department Head
Staff Engineer
Laboratory Technician
Clerk
Shift Supervisor A
Shift Supervisor B
Shift Supervisor C
Shift Supervisor D
Group Leader 2 Mixers 2 Helpers
Group Leader 2 Mixers 2 Helpers
Group Leader 2 Mixers 2 Helpers
Group Leader 2 Mixers 2 Helpers
Group Leader 2 Mixers 2 Helpers
Group Leader 2 Mixers 2 Helpers
Group Leader 2 Mixers 2 Helpers
Group Leader 2 Mixers 2 Helpers

The helpers were usually young men 18 to 25 years of age; the mixers, 25 to 40; and the group leaders and foremen, 40 to 60. Foremen were on salary; group leaders, mixers, and helpers were on hourly pay.

To produce 20 million pounds of product per year, the department operated 24 hours a day, seven days a week. Four crews rotated shifts: for example, shift foreman A and his two group leaders and crews would work two weeks on the day shift (8:00 a.m. to 4:00 p.m.), then two weeks on the evening shift (4:00 p.m. to midnight), then two weeks on the night shift (midnight to 8:00 a.m.). There were two days off between shift changes.

During a typical shift, a group leader and his crew would complete two or three batches. A batch would frequently be started on one shift and completed by the next shift crew. There was slightly less work on the evening and night shifts because no deliveries were made, but these crews engaged in a little more cleaning. The shift foreman would give instructions to the two group leaders at the beginning of each shift as to the status of batches in process, batches to be mixed, what deliveries were expected, and what cleaning was to be done. Periodically throughout the shift, the foreman would collect samples in small bottles, which he would leave at the laboratory technicians' desk for testing.

The management and office staff (department head, staff engineer, lab technician, and department clerk) worked only on the day shift, although if an emergency arose on the other shifts, the foreman might call.

All in all, the department was a pleasant place in which to work. The work floor was a little warm, but well lit, quiet, and clean. Substantial banter and horseplay occurred when the crew wasn't actually loading batches, particularly on the evening and night shifts. The men had a dartboard in the work area and competition was fierce and loud.

Frequently a crew would go bowling right after work, even at 1:00 a.m., because the community's alleys were open 24 hours a day. Department turnover and absenteeism were low. Most employees spent their entire career with the company, many in one department. The corporation was large, paternalistic, and well-paying and offered attractive fringe benefits including large, virtually automatic bonuses for all. Then came the change.

The new system: To improve productivity, the acetate department was completely redesigned; the technology changed from batches to continuous processing. The basic building was retained but substantially modified as in Exhibit 8.18. The modified workflow is as follows:

1. Most solid raw materials are delivered via trucks in large aluminum bins holding 500 pounds.
2. One handler (formerly helper) is on duty at all times on the first floor to receive raw materials and to dump the bins into the semiautomatic screw feeder.
3. The head operator (former group leader) directs the mixing operations from his control panel on the fourth floor located along one wall across from the

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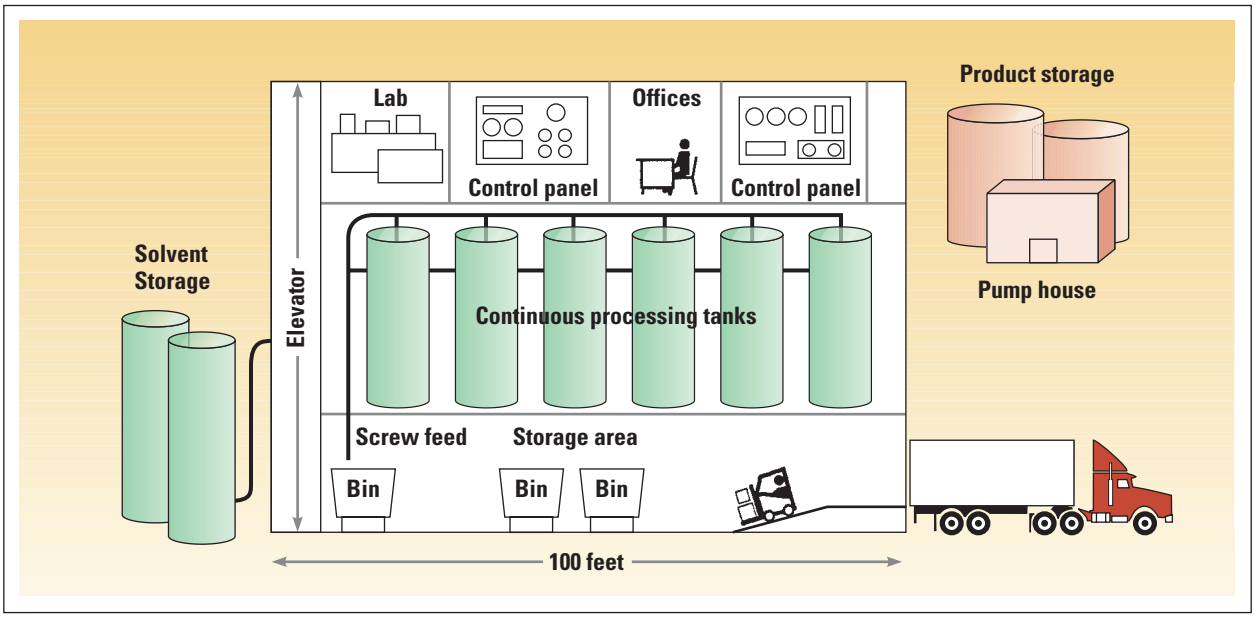
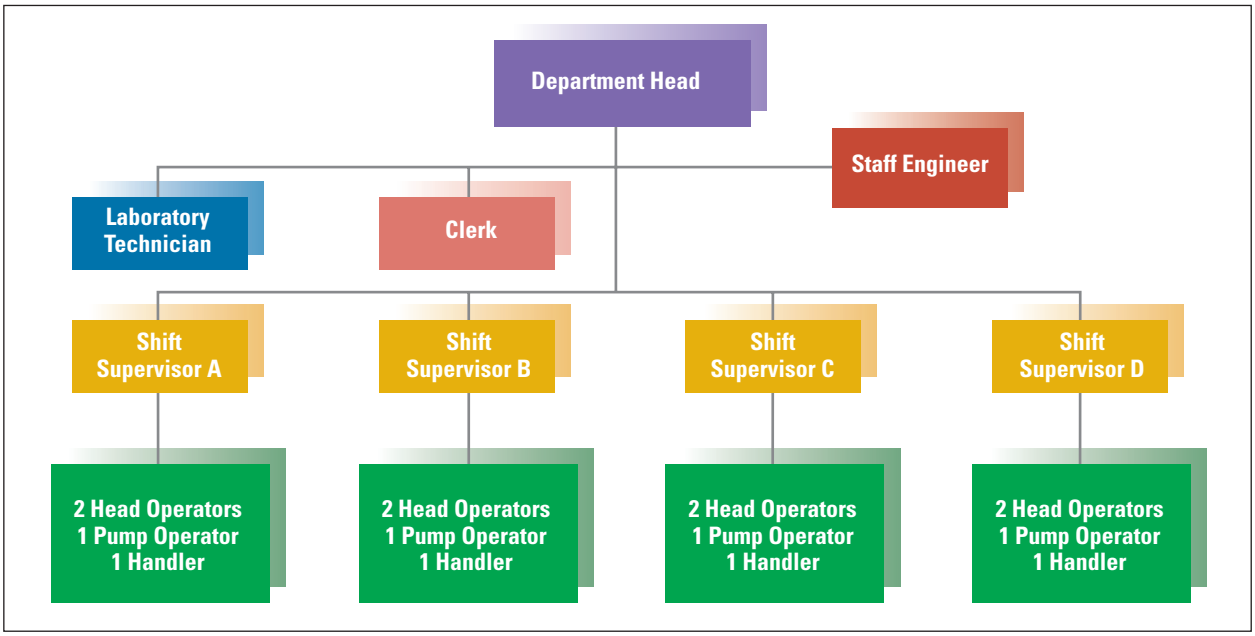
EXHIBIT 8.18
Elevation View of Acetate Department after Change



department offices. The mixing is virtually an automatic operation once the solid material has been sent up the screw feed; a tape program opens and closes the necessary valves to add solvent, heat, mix, and so on. Sitting at a table before his panel, the head operator monitors the process to see that everything is operating within specified temperatures and pressures.

This technical change allowed the department to greatly reduce its workforce. The new structure is illustrated in Exhibit 8.19. One new position was created, that of a pump operator who is located in a small, separate shack about 300 feet from the main building. He operates the pumps and valves that move the finished product among various storage tanks.

EXHIBIT 8.19
Organizational Chart of Acetate Department after Change


Department Head
Staff Engineer
Laboratory Technician
Clerk
Shift Supervisor A
Shift Supervisor B
Shift Supervisor C
Shift Supervisor D
2 Head Operators 1 Pump Operator 1 Handler
2 Head Operators 1 Pump Operator 1 Handler
2 Head Operators 1 Pump Operator 1 Handler
2 Head Operators 1 Pump Operator 1 Handler

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Under the new system, production capacity was increased to 25 million pounds per year. All remaining employees received a 15 percent increase in pay. Former personnel not retained in the acetate department were transferred to other departments in the company. No one was dismissed.

Unfortunately, actual output has lagged well below capacity in the several months since the construction work and technical training were completed. Actual production is virtually identical with that under the old technology. Absenteeism has increased markedly, and several judgmental errors by operators have resulted in substantial losses.

Questions

1. How does the technology change from small-batch to continuous process in the Acetate Department reflect the differences in structural characteristics suggested by Woodward in Exhibit 8.4?
2. How do you think task variety and analyzability changed in the Acetate Department?
3. Why do you think production might be lagging with this new technology? What suggestion would you make to improve production?

CASE FOR ANALYSIS | Digitalization in the Manufacturing Sector: Skills in Transition[101]

Fifty-year-old Paul Sandberg glanced up from his CNC (computer numerically controlled) turning machine to the computer control office above him on the 2nd floor of the workshop. A new program had been initiated that morning and, despite earlier tests, something wasn't working well. He was now waiting for Jonas Holm, the 27-year-old computer technician, to come down and fix the problem.

Sandberg had been manufacturing parts as a machine operator for several decades. He had learned machining hands-on, had known what a part should feel like when it was well done, and he had learned to make manual alterations in the machining process to fix problems as they occurred. But all of that had changed about 15 years ago, when new technologies, including 3D CAD/CAM (computer-aided drawing and manufacturing), and CNC machining, had been introduced in the company.

The entire design and manufacturing process had been overhauled. Designs were now made from the viewpoint of assembly, not machining, with 3D manufacturing instructions. Technicians, such as Holm, then developed computer programs from the 3D instructions for the CNC machines. After testing, the technicians connected their computers on the 2nd floor to the CNC machine on the ground floor and installed the program. The technicians were responsible for checking that the machine worked as expected in collaboration with the operator. They also provided the operator with simplified paper working instructions. Overall, the increased digitalization appeared to be good for the skill development of the technicians.

As Holm noted:

> "Digitalization has developed our competencies. It's positive because that's what the company needs: complex job tasks."

The operators, on the other hand, had to accept a decrease in autonomy and job discretion because of the manufacturing technicians' programming of the machines. Sandberg, as other older operators, was skeptical about the understanding of the processes underlying the 3D drawings and the work of the CNC machines. He argued that:

> "The Company should try to employ some other people, with more experience . . . (because)... those my age and 50+. . . here is a fantastic competence."

When CNC machining had first been introduced, the operators had been trained to program the machines themselves; now, with 3D CAD/CAM, technicians were responsible for programming and program modifications. One of Holm's colleagues commented:

> "We received many new machines in the years 2013-2014. We started to work extensively to train the operators. They had to learn more, dare to test more, and to take greater responsibility."

As Sandberg could testify, the operator jobs had drifted away from craftwork, to simply setting and controlling the CNC Machines. According to experienced operators, the jobs had been "de-skilled"; knowledge of the craft of machining was disappearing. On the one hand, older employees felt that their hard-earned experience and knowledge had lost importance and become almost worthless; on the other hand, new machine operators could more easily and quickly be trained for the job.

Computer programs now controlled the process. Sandberg expressed this:

> "Like other operators my age, I am experienced in turning. I began my career turning manually. You developed a bit more feeling for what you were doing. You came closer to the material; you could see what was good and what was not good.

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> Youngsters, that only use steered machines, they don't get that feeling. People older than me, they are phenomenal to turn manually. This competence is disappearing; it's a craft that's disappearing here."

There were other drawbacks as well, including a loss of job discretion and potential boredom:

> "There's not much problem solving. In case of problems, we call the repairer."

But this also resulted in less stress:

> "It's good to escape problem solving. It's stressful when you know that there is a rush for more… to be produced. If I stand here and try to fix (a problem), nothing happens."

There was some variety of work for Sandberg; with the increasing growth of the company, operators were manufacturing a greater variety of parts, so he needed to adjust the CNC machines more often.

Sandberg's young colleague, Holm, had worked as an operator for seven years before being promoted to computer technician. But he had started his career after the introduction of the new technologies, so he had never had to manually machine a part himself. There was always an absence of this shared experience and knowledge whenever he tried to "speak the same language" as Sandberg or the older operators. Still, digital technologies for him meant a bright future. The increased variety of components that Flying Parts was manufacturing meant that he was gaining in knowledge and experience in conversion of 3D drawings to manufacturing instructions for programming and to 2D instructions for operators. But it also meant a more stressful job.

> "At times, it can be extremely stressful. The psychosocial environment is very tough, I think."

Questions

1. What is meant in the case by "jobs being de-skilled"? Do you think the knowledge and skillsets based on older technologies are worth saving for a company? Explain.
2. Do you think computer technicians should be hired directly from school or hired from among existing operators and retrained into the new job? Why?
3. How might a company best work through the transition from an old to a new manufacturing technology with its employees? Discuss.

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CHAPTER

9 Designs for Digital Organizations and Big Data Analytics

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Learning Objectives

After reading this chapter you should be able to:

1. Explain the impact of digital technology on organizations as it evolved from mainframe computers to the Internet of Things.
2. Describe the differences between a traditional "pipe" organization and a new "platform" organization.
3. Define how big data analytics is distinct from previous data analysis activities within organizations and specify various approaches to organizing big data scientists within an organization.
4. Explain how artificial intelligence improves efficiency and decision making in organizations and discuss its potential downsides.
5. Explain how IT can be used for social network analysis and knowledge management in organizations.
6. Describe how organizational design is changing because of advances in artificial intelligence.

Chapter Outline

The Digital Information Explosion

Pipes versus Platforms: A New Organization Form

Two Types • Foundational Assumptions • Platform Design Recommendations

Big Data Analytics

Big Data Requirements • Big Data and Organization Structure

Artificial Intelligence

Is AI an Objective Decision Maker? • Is Nudge Management Going to Be Your Coach? • Algorithmic Control May Be Your New Boss • AI Implications for Organization Design

Other Digital Applications in Organizations

Social Network Analysis • Knowledge Management

Digital IT Impact on Organization Design

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **Platform-based organizations are a new form of organization, but the fundamental assumptions are the same as for a traditional industrial organization.**

I AGREE _____ I DISAGREE _____

2 **Artificial intelligence is objective and bias-free compared to human decision making in organizations.**

I AGREE _____ I DISAGREE _____

3 **Big data analytics gives good results for making decisions by using carefully selected samples of data.**

I AGREE _____ I DISAGREE _____

A few weeks before the H1N1 flu virus made headlines, engineers from Google published a surprising paper in the scientific journal *Nature*. It explained how Google could predict the spread of the winter flu in the United States down to specific regions and even states. Google gets more than three billion search queries every day and saves them all. Engineers took the 50 million most common search terms and compared the list with Centers for Disease Control data on the spread of seasonal flu between 2003 and 2008, looking for correlations between the frequency of certain search queries and the spread of flu. They processed 450 million different mathematical models to test the terms, comparing their predictions against actual flu cases. The Google team struck gold: the software found a combination of 45 search terms that had a strong correlation between their predictions and the official figures. The *Nature* paper was largely overlooked outside the world of computer scientists, but it created a splash among health officials. When a new virus emerges and spreads quickly, the only hope health officials have is to slow the spread of the disease, but to do that they need to know where it already is. Although the CDC receives information from doctors, public health clinics, and hospitals, the data are always a couple of weeks out of date. With a rapidly spreading disease, two weeks is an eternity. Google's method, built on the power of "big data," could tell where the flu had spread in near real time, not a week or two after the fact.[1]

Big data is one of the most recent advances in the field of information technology (IT), and it is reshaping companies and entire businesses. Amazon.com collects tons of data on customers, including what books they buy, what else they look at, how they navigate through the website, and how much they are influenced by promotions and reviews. The company uses algorithms that predict and suggest what books a customer might be interested in reading next. Netflix uses big data analytics to predict the types of shows you will want to watch. Moreover, the predictions get better every time a customer responds to or ignores a recommendation.[2]

Today, IT developments have sparked the creation of a new organizational form, called a platform-based organization, including companies such as Facebook, Airbnb, and Uber, which are truly digital organizations. Within traditional large companies, big data analytics has also spawned new business opportunities.

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In addition, a large corporation can create its own digital platforms to connect employees on key projects. These new forms of IT are digitalizing organizations in all industries to maintain a competitive edge in the face of growing global competition and rising customer demands for speed, convenience, quality, and value. The primary benefits of digital technology for organizations include its potential for improving decision making as well as for enhancing control, efficiency, and coordination of the organization internally and with external partners and customers. Some organization theorists believe new digital technology developments are gradually replacing the traditional hierarchy in coordinating and controlling organizational activities.[3]

Purpose of This Chapter

Information is the lifeblood of organizations. Managers spend at least 80 percent of their time actively exchanging information. They need this information to hold the organization together. The vertical and horizontal information linkages described in Chapter 3 are designed to provide managers with relevant information for decision making, coordination, evaluation, and control. It isn't just facilities, equipment, or even products and services that define organization success, but rather the information managers possess and how they use it. Highly successful organizations today are typically those that apply the advances in digital technology most effectively.

The ways in which organizations collect and use information has changed dramatically in recent years. This chapter examines the evolution of IT from mainframe computers to digital organizations. The chapter begins by looking at the explosion of digital information in the organizational world. Then the chapter explores the new form called platform-based organizations, followed by the application of big data analytics and artificial intelligence in extant organizations. The remaining sections of the chapter related to new information technologies include a discussion of knowledge management within companies, and how companies add strategic value through the use of internal network analysis. The recent digital innovations are a natural outgrowth of earlier applications and have led to a quantum leap in new business opportunities, a dramatic jump in business digitalization, strengthening internal and external organizational relationships, and strategic success. The final section of the chapter presents an overview of how digital innovations affect organization design.

9.1 The Digital Information Explosion

Traditional information media involved a human being. The telephone, television, and radio media were focused on a human participant. In the early days of computers, the essential communication was still between a computer and a human being. That changed with the advent of digital media. **Digital media** means that information or data can be both created and consumed by machines, and thereby be generated, modified and distributed on digital electronic devices. A human being is not required.

Exhibit 9.1 illustrates the evolution of IT. Initially, mainframe computer systems in organizations were applied to operations. These initial applications

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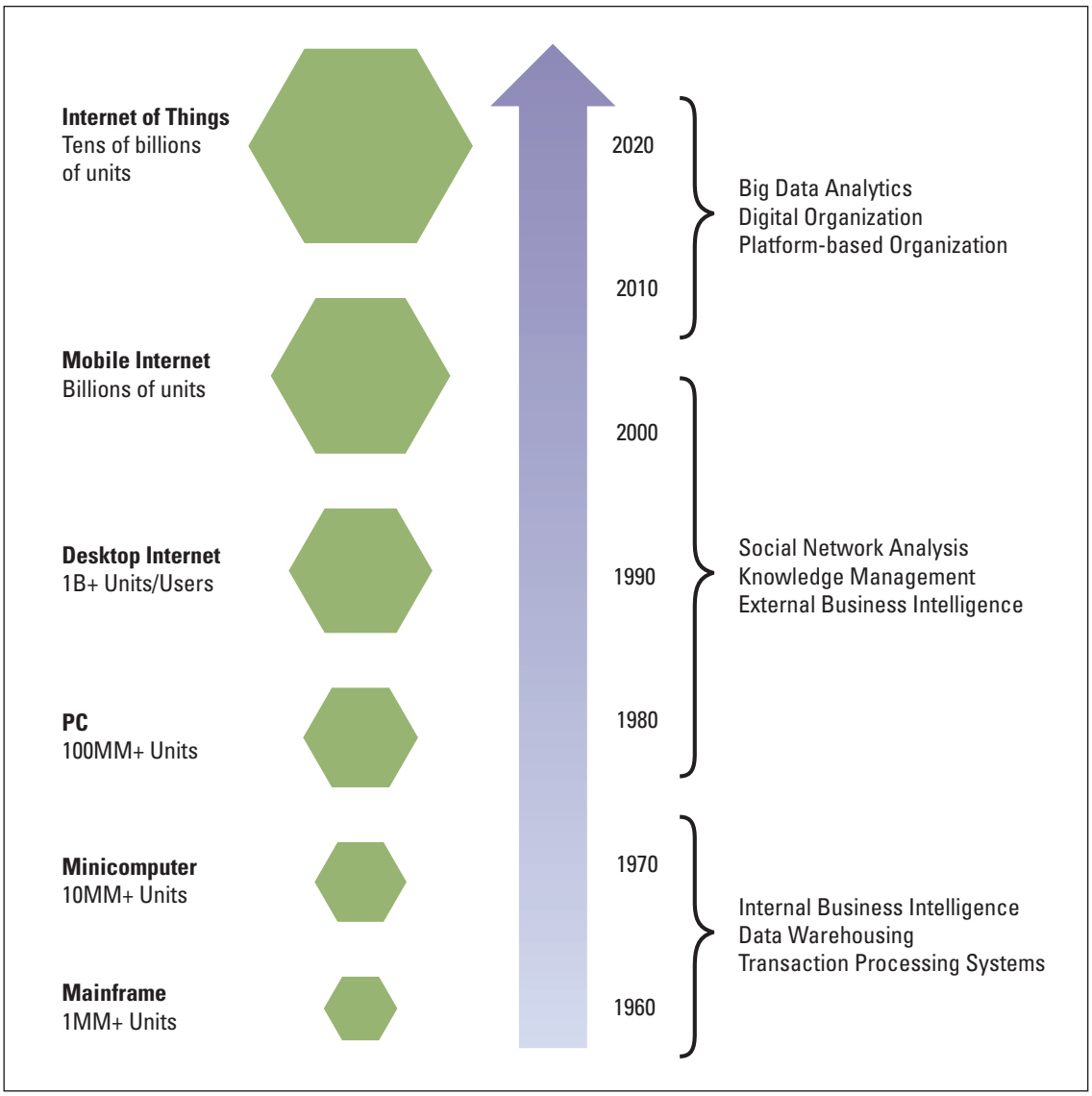
EXHIBIT 9.1
Evolution of Information Technology



were based on the notion of machine-room efficiency—that is, current operations could be performed more efficiently with the use of computer technology. These systems became known as **transaction processing systems** (TPSs), which automate the organization's routine, day-to-day business transactions. A TPS collects data from transactions such as sales, purchases from suppliers, and inventory changes, and stores them in a database. For example, at Enterprise Rent-A-Car, a computerized system keeps track of the 1.4 million transactions the company logs every hour. The system can provide front-line employees with up-to-the-minute information on car availability and other data, enabling them to provide exceptional customer service.[4]

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The mainframe also enabled the subsequent use of data warehousing and internal business intelligence software to expand the usefulness of these accumulated data. **Data warehousing** is the use of large databases that combine all of a company's data and allow users to access the data directly, create reports, and obtain responses to what-if questions. **Internal business intelligence** refers to the high-tech analysis of a company's data in order to make better strategic decisions.[5] Sometimes referred to as *data mining*, business intelligence means searching out and analyzing data from multiple databases across the enterprise, and increasingly from outside sources as well, to identify patterns and relationships that might be significant. Retailers are some of the biggest users of business intelligence software. Managers at companies such as Wet Seal, a fast-fashion clothing company selling mainly to teenage girls and young women, and Elie Tahari, a maker of designer clothes, need to spot changing sales trends fast, so they are continually mining sales data. Wet Seal created a web feature called Outfitter that allows users to put together their own outfits online; mining the 300,000 user-generated outfits gave managers an early lead on the trend toward wearing dressy tops with casual pants and jeans.[6]

Mini-computers were smaller and cheaper versions of the mainframe that could be used in parts of the organization away from the centralized mainframe. They were smaller versions of transaction processing systems. The development of desktop computers meant that every person could have a computer on which to communicate with other people, do one's own work, and connect to larger databases. This was an even more decentralizing process than the mini-computer, and connected desktops allowed people to share information via knowledge management systems. The use of connected desktop computers also enabled network analysis. Both knowledge management and network analysis will be described later in this chapter.

The advent of the wired Internet was a big breakthrough for information technology. Suddenly employees could gain access to a huge web of information from around the world.[7] The mobile Internet enabled the emergence of **big data analytics**. This is one of the newest business technologies and refers to new sensing technologies and processes for gathering, searching and analyzing massive, complex sets of data that traditional data processing applications cannot handle to uncover hidden patterns and correlations.[8] Walmart collects more than 2.5 petabytes of data every hour from customer transactions and uses those data to make better decisions (a petabyte is about a million gigabytes or the equivalent of about 20 million filing cabinets full of written data).[9] Facebook uses the personal data you put on your page and tracks and monitors your online behavior, and then searches through all those data to identify and suggest potential "friends" and to target advertisements. The majority of this chapter focuses on these two higher-level stages in the evolution of IT.

The most recent jump in the information explosion is to the internet of things. The term "Internet of Things" was coined by the British technology pioneer Kevin Ashton in 1999. Previously, the Internet had been dependent on people for its supply of information. But now impersonal "things" can themselves generate and receive data. Now things are connected and can communicate with each other. Billions of devices, including laptops, PCs, and especially smartphones, generate trillions of data points. Connecting devices to automated analytical systems makes it possible to gather information, analyze it, and create a response without human intervention.

Now every "thing" can have a chip inserted to communicate data to other devices. A "thing" could be a hairbrush, a home thermostat, a shirt or dress, a toaster, a refrigerator, a fitness collar for your dog, or a baby thermometer. In business, a thing can be something as large as a jet engine or a railroad locomotive. Each of these dumb items becomes smart and linked into the Internet with potential for two-way

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communication. For example, in a "smart" home keyless door locks would send a text message when activated, lights would switch on or off when there is movement in a room, air conditioning or heating could be turned on or off based on personal preference and people's locations, and the same with refrigerators and coffee machines.[10] With the application of advanced analytics for artificial intelligence, these data had the potential to provide companies with better insight into users and devices. Artificial intelligence could also control devices in various ways. For example, clothing equipped with sensors would be able to detect when an older or ill person fell, and small containers holding medications would "note" whether a patient had taken prescribed pills and could send an email or text message reminder when needed.

The Internet of Things also enabled the latest stage of digital organizing, which is the new platform-based form of organization. The platform-based organization relies heavily on technology to connect producers and consumers digitally, thereby requiring fewer people, buildings, or infrastructure.

REMEMBER THIS

- Mainframe computers in the 1960s allowed organizations to undertake transaction processing systems, data warehousing, and internal business intelligence.
- Later developments in personal computers and the Internet supported knowledge management, social network analysis, and external business intelligence.
- The Internet and mobile devices enabled the development of platform-based digital organizations.
- The Internet of Things enabled tens of billions of data-gathering units and the prominence of big data analytics in an ever-increasing number of organizations.

9.2 Pipes versus Platforms: A New Organization Form

The traditional organization that has been around for ages is called a "pipe." This has been the dominant form of successful business corporations. Pipe firms work in a linear order, acquiring resources at one end of the pipe, making stuff within the pipe, and pushing the result out the other end for sale to customers. The pipe represents a sequential process to produce a good or service. Every consumer product that people have used in the past essentially came to us through a pipe organization. All manufacturing runs on a pipe model. Television and radio are also pipes discharging content for us. The education system is a pipe because teachers push knowledge out of the school pipe. Prior to the Internet, most of the service industries ran on a pipe model as well.[11]

Without the Internet and mobile digital devices, platform-based businesses would not have been possible. Platforms do not make stuff and push it out to customers. **Platform-based organizations** connect and enable users to both create and consume something of value. As a business, a platform allows users to create value on the platform for other users to consume. This is a huge shift from any organizational form we have known during the industrial era. In a platform-based organization, producers and consumers are connected via digital technology (computers,

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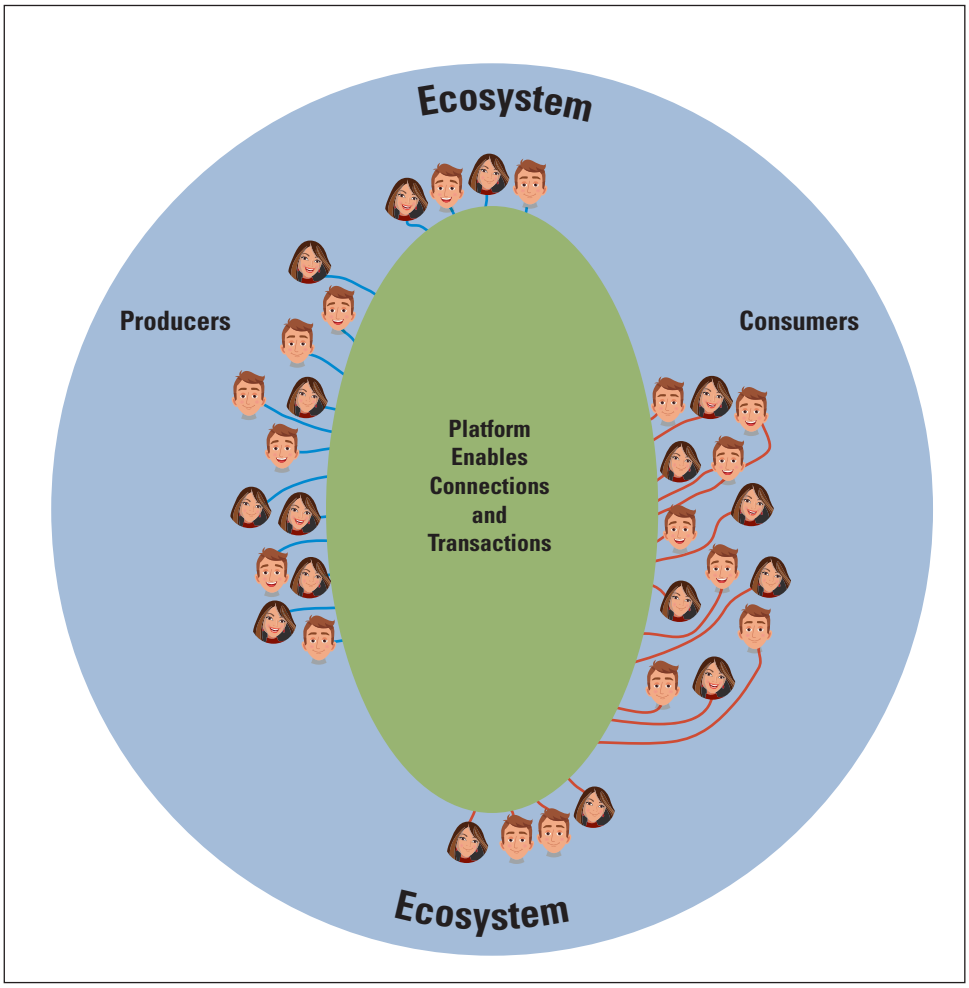
smartphones). For example, YouTube or Airbnb are digital connectors that link thousands of independent producers (videographers, individuals with homes, rooms, or apartments for rent) with thousands of consumers (video watchers, vacationers). The owners of the platform-based business provide the software and the central processing computers that connect other people into the ecosystem (Chapter 5) it created. The users both create and consume any product or service.[12] The owners can earn money by charging a fee for the transaction or by exposing users to advertising.

As illustrated in Exhibit 9.2, a platform is a business model that creates value by facilitating exchanges (connections) between two or more interdependent groups, usually consumers and producers. In a large platform organization like Facebook, other groups such as app developers may participate as well. To encourage exchanges, platforms harness and create large networks of users and resources (producers) that can be accessed on demand. Platform-based organizations create communities that allow users to interact directly with one another via their digital media devices. Platform businesses such as Facebook, Uber or Alibaba, do not create and control inventory via a supply chain the way linear organizations do. Successful platforms facilitate connections by dramatically reducing the cost of exchanges between producers and consumers.[13]

EXHIBIT 9.2
Platform-Based Digital Organization Ecosystem



Source: Based on Alex Moazed, "Platform Business Model—Definition; What Is It? Explanation," Applicoinc.com, Platform Innovation Blog, May 1, 2016, https://www.applicoinc.com/blog/what-is-a-platform-business-model/ (accessed May 20, 2019).

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A platform-based business is a complete organizational form, not just a piece of technology. It is more than a website or a piece of software. It is a whole organization that creates value by bringing together producers and consumers. This is a giant change from traditional businesses that use a supply chain and operational processes to make and sell tangible products. The dramatic shift in thinking is that what a company owns matters less than the resources it can connect together.

9.2a Two Types

Most platform-based organizational forms are one of two types. **Exchange platforms** facilitate 1:1 interactions among members. **Maker platforms** facilitate 1:1,000s interactions among members. A ride-hailing company such as Lyft is an example of a 1:1 interaction (exchange platform). A single passenger (consumer) books a single driver (producer). During the ride the driver is not available on the platform to connect with another rider. The consumer and producer engage in a single transaction. On the other hand, on maker platforms the producer creates something that a large number of consumers can use simultaneously, such as a YouTube video. The same is true for a livestream on Twitch, where many people can watch other users playing video games. The producer is broadcasting to as many people as possible to consume the broadcast. The fundamentals of both types of platform-based organization are the same in the sense that they provide a digital connection among producers and consumers, and the business is anchored in digital transactions rather than the exchange of physical products or services based in buildings and equipment.[14]

Amazon started as a maker platform by making books available to a rapidly growing number of consumers. Its ecosystem was relatively small and the platform connected consumers (book buyers) with the supply of books. As Amazon began allowing other businesses to sell goods on its website, it evolved to more of an exchange platform. The businesses selling on the site are producers and purchasers are the consumers. In the case of autonomous small businesses, Amazon does not provide any products. Amazon provides the digital platform and software that facilitates the digital connections among producers and consumers.

The two most successful platform-based businesses to date are Google and Facebook. The number of platform organizations at the highest level of the world economy is growing fast. In 2016, four of the top five companies on *Forbes*'s list of most valuable brands were platform companies, as were 11 of the top 20. As of 2017, the top five companies by market capitalization in the United States were all platform businesses. Some platform businesses you may recognize include Amazon, eBay, Zillow, Instagram, YouTube, Twitch, WhatsApp, Waze, Lyft, Pinterest, Square, and Kickstarter. Platform companies such as Alibaba, Tencent, and Baidu are prominent in China and much of Asia.[15]

9.2b Foundational Assumptions

The basic assumptions underlying a traditional company no longer apply in new platform-based companies. These assumptions pertain to assets, hierarchy, and control.[16]

Pipe Assumption 1. The first assumption of traditional linear industrial organizations is to create competitive advantage through increasing size of capital assets, including buildings, manufacturing facilities, administrative functions, and support

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structures. Pipe companies acquire size and impact through mergers and acquisitions to gain market share, pricing power and global reach.

Platform Assumption 1. Capital assets can be owned by the connected producers and consumers of the platform. The platform can minimize rather than add assets. Consumers can get news from their own computers or smartphones rather than from a manufactured newspaper. Hotel companies (pipe organizations) build and own huge buildings in which to house guests, but the Airbnb buildings in which guests are housed are owned by the dispersed owners who rent their apartment or house to consumers on Airbnb's platform. Lyft and Uber do not own the cars or employ the drivers used in their ride-hailing businesses. The transportation assets (autos) are owned and provided by the drivers, who are considered independent contractors rather than company employees.

Pipe Assumption 2. Organizations act as information processing structures or hierarchies (Chapter 3), such as the British Army, McDonald's, the Roman Catholic Church or Southwest Airlines. Important information moves toward the center and top levels of the organization for decision-making.

Platform Assumption 2. Information in the digital era travels extremely fast and widely. For example, Twitter notified the U. S. Eastern Seaboard of an earthquake emanating from southern Virginia. Emergency workers, communities, and other stakeholders received the information faster than what a business organization could provide. Social media and new digital technologies move information better than the old formal organization systems. Thus, the formal organizational hierarchy is not effective for processing information at light speed.

Pipe Assumption 3. Managers are promoted into positions of increasing responsibility as they gain experience and show talent for making bigger decisions for the company.

Platform Assumption 3. Algorithmic systems embedded in the platform software are more consistent, impartial, and faster for making decisions than are humans in many areas. An **algorithm** is a set of systematic rules built into the platform software to accomplish desired outcomes in many areas. As an example, Google uses algorithms to rank the results for each of the millions of searches on its website each day. The decisions are better and faster than humans could do. Why use a slow chain of command to make decisions when algorithms can make most decisions faster and better?

Traditional organizations may seem clumsy and slow compared to the new platform organizations. The new form uses fewer assets, communication is much faster than in human hierarchies, and many decisions are made quicker and more objectively. However, even platform organizations need a hierarchical structure for some aspects of the core business. One suggestion is that the human hierarchy of the platform organization should be focused more on culture processing than on information processing.[17] Digital platforms cannot shape culture, which is a human activity. Without direction from the leaders and hierarchy, the culture of a platform organization may go awry. Consider the case of Uber. Uber fits the platform model assumptions. Capital investment is modest because drivers are contractors rather than employees and they pay for their own cars. Uber has far fewer employees and physical assets when compared to traditional companies of similar market value. Uber is lean at the corporate level because there is no need for human dispatchers or interviewers, a large marketing organization, or a large HR department to manage drivers as employees. The software app makes

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transactions seamless and nearly effortless for both rider and driver. Communication between producer and consumer is nearly instantaneous via digital devices connecting through the platform.

IN PRACTICE

Uber

Uber is one of the better-known platform-based companies and operates unlike traditional organization forms. Interactions with the company are strictly digital. To get a ride on Uber, you download the app and create an account. When you open the app, your location is detected via GPS. The app also shows nearby drivers on the map. When you agree to the estimated fare you are connected to the Uber driver who can accept your request within seconds. The driver receives data on the rider's previous Uber experience and can accept or reject a request. Uber uses a bidirectional rating system to flush out bad riders and drivers, who can be deactivated. You can track the car on your screen as it approaches. The driver has your desired destination in the built-in GPS. When the ride is completed, the fair is automatically paid through the app.

Uber experienced growing pains associated with aggressive growth goals designed to dominate the emerging platform-based ride-hailing industry. The corporate culture was left to evolve on its own with little attention from management. In 2017, two former employees posted long blog posts detailing repeated experiences of sexual harassment and the failure of HR executives to respond. Moreover, many cities responded negatively to Uber's willful ignorance of ride-hailing regulations. London suspended Uber for a period of time until it became a better corporate citizen. Uber co-founder and CEO Travis Kalanick was videotaped berating the driver of an Uber car who complained about the company's payments to drivers. The video went viral.[18]

What went wrong at Uber? Executives did not focus their attention on forming and reinforcing a positive organizational culture and values. A "tech-bro" culture emerged that was unsatisfying to internal employees as well as many drivers and riders. Uber's early-stage focus on growth at all costs created a backlash. Some users boycotted Uber and urged others to do the same. Uber drivers and riders are regulated, instructed, and evaluated by software algorithms. Algorithms run almost everything at Uber, including how drivers are hired, retained and rated, surge pricing, driver dispatch, and advertising.[19] The fundamental belief in algorithms to run company operations allowed the culture to go out of control. The organizational hierarchy is a better mechanism for influencing organizational culture and values. Senior leaders in the hierarchy at platform companies should think of themselves as culture-processers rather than information-processers. Travis Kalanick was dismissed as CEO and a new CEO, Dara Khosrowshahi, was hired to improve Uber's culture values and reputation. Algorithms cannot establish cultural norms or inspire loyalty. The current CEO and other top leaders are working to establish a whole healthy culture at Uber.[20]

ASSESS YOUR ANSWER

1 Platform-based organizations are a new form of organization, but the fundamental assumptions are the same as for a traditional industrial organization.

ANSWER: *Disagree.* The basic assumptions underlying a traditional company no longer apply in new platform-based companies. Platform-based companies use fewer assets, information travels faster and more widely, and there is less need for hierarchy than in traditional companies.

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9.2c Platform Design Recommendations

Platform-based organizations are still relatively new. There have been few studies exploring the impact of platforms on organization design. There are no hard and fast rules for platform-based companies, but a number of recommendations have emerged based on what is known about this new organizational form. To effectively design a platform-based organization, leaders should influence a positive corporate culture, invest in employee talent, and develop employees' soft skills.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Use a platform-based organization because it uses fewer capital assets, enjoys rapid digital communication, and employs less hierarchy than a traditional organization. Decide whether to be a maker platform or an exchange platform. Influence a constructive corporate culture so that a "tech-bro" culture does not emerge.

Envision a Constructive Culture. CEOs and other top leaders should be capable of communicating their vision for both the cultural and digital dimensions of their companies. The technical/digital mindset within a platform business should not overwhelm or take priority over corporate culture. In one survey, companies whose employees think they made an effective digital transformation tend to have cultures that value agility, risk taking, distributed leadership, collaboration, and data-driven decision-making.[21] These cultures do not happen by accident. Leaders must proactively establish the desired cultural norms and values. Technology-focused employees may be content to let culture emerge on its own, in which case core values are less predictable. A change management consultant proposed that culture is the most important part of the digital transformation process. Rather than letting technology drive culture, it should be the other way around. Leaders should set culture norms first, and then proceed with building the new technology platform and infrastructure.

As one real-life example of culture oversight, Uber's culture became anything but constructive during the founding CEO and other top managers' intense focus on rapid growth to the exclusion of establishing positive culture values, as described earlier. Fortunately, the company's new CEO and top management team are toning down Uber's grow-at-all-cost values while working to build a more collaborative culture and repair Uber's "bad-boy" reputation.[22]

Invest in Digital Talent. Acquiring the right talent with the right digital skills and mindset is a challenge for many companies. There is a scarcity of digital talent. During a labor shortage, it is as important to hold onto current talent as it is to find new talent. A culture that allows people to experiment and make mistakes is attractive to employees. When a company is transitioning to a digital organization, current employees who do not have strong digital skills often prefer training within the organization to leaving to join another company. A study by MIT Sloan School of Management found that over half of employees at companies in the early stages of digital transformation were planning to leave their organization in the next three years. This was true for senior management as well, largely because of a lack of opportunity for digital development opportunities. Digitally mature organizations are more than five times as likely as their peers to provide resources and opportunities to develop their employees' digital acumen.[23] A McKinsey report suggests that a lot of talent can be nurtured inside the firm rather than always recruiting technical specialists from outside. Just basic digital competency may be better than deep technical knowledge.[24]

It is smart for a platform company to become a magnet for talent. Employees and executives are highly inclined to jump ship if they feel they do not have opportunities to develop digital skills. Consider that VP-level executives without

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sufficient digital opportunities are 15 times more likely to want to leave within a year than are those with satisfying digital challenges. In successful digital companies, development efforts for talent management go far beyond traditional training. These businesses create compelling cultural norms for achieving career growth ambitions while acquiring digital skills and experience, which help employees want to stay.[25]

Promote Soft Skills and Team Building. In a digital world, the technology tools change so fast that technical skills may seem transient. The companies best prepared to handle a digital transformation tend to focus on developing employees' human skills. Studies have found that, when putting together a list of skills needed for effective twenty-first century organizations, soft skills like communication and developing a network are equally important to technical skills. In an open-ended survey question, 38 percent of respondents said that instead of technical know-how, a change-oriented mindset, including the ability to be flexible, adaptable, and curious, was the skill most central to success in a digital workplace. Although Walmart is not a platform organization, as it develops employees' digital skills, it also encourages them to collaborate across organizational boundaries. Walmart purposefully organizes activities to create "collisions" between associates working on projects who might not have worked together previously. One thing that accelerates results at Walmart is when people who have different backgrounds and come from different regions are now working together on common problems.[26]

Breaking down functional silos and focusing on cross-functional collaboration is considered crucial to success in digital environments. More than 70 percent of digitally maturing businesses are using cross-functional teams to organize work and are charging these teams with implementing digital business priorities. The need for soft skills is based on the drive for cross-functional teams because digital employees do not function in isolation. The processes in a platform-based organization are tightly integrated, so effective collaboration enables greater organizational effectiveness. Cross-functional teams are what enable a terrific customer experience. Cross-functional teams also encourage employees to think differently and more broadly. Participating in a cross-functional team pulls people out of their small segment of the business to see the bigger picture. The importance of working cross functionally has become so important that some companies are using special interviewing tools to ensure that new hires have the requisite soft skills and cross-functional team abilities to get work done.[27]

People want to work in a culture that encourages them to continuously learn, grow, and gain new digital experiences. One way some companies help employees keep learning is to encourage them to participate in digital platforms and digital communities away from work. They can share ideas with and learn new skills from experts in other organizations. Instead of asking staff members to be secretive about their work, some businesses encourage people to be active on platforms such as GitHub, where they can collaborate on the development of cutting-edge technical tools. This strategy can help attract and retain employees who want to learn about the newest technologies while also gaining better social skills from working on these collaborative projects. Organizations that do not develop employee talent are likely to see employees and executives jump ship to competitors that do.[28]

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REMEMBER THIS

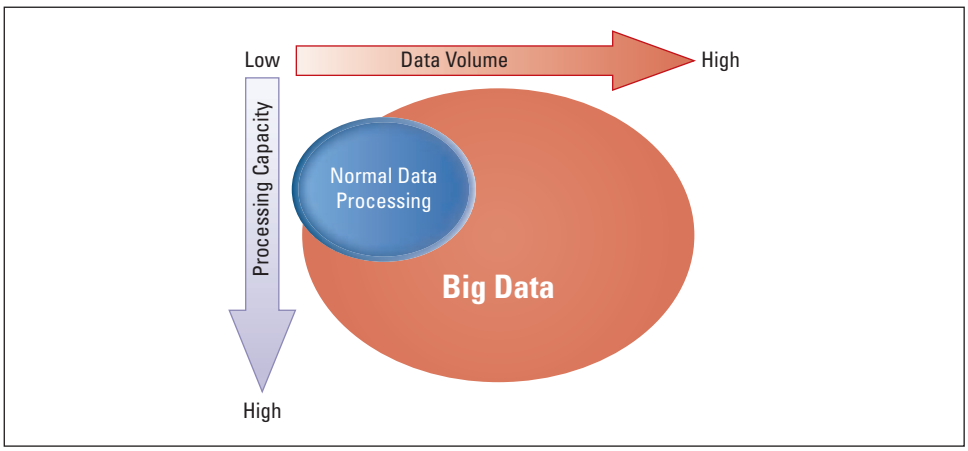
- The "pipe" is a traditional organization that transforms raw materials into products or services for customers.
- The "platform" is a new organizational form that digitally connects producers and consumers rather than producing a product or service of its own to sell.
- Platform-based digital organizations are of two types. Exchange platforms facilitate 1:1 producer-consumer interactions among members (think of Uber). Maker platforms facilitate 1:1,000s producer-consumer connections (think You Tube).
- The foundational assumptions of platform-based digital organizations differ from those of pipe organizations in that they use fewer assets, there is faster information flow, and there is less hierarchy.
- Platform-based digital organizations can lose control of corporate culture and therefore leaders must try to influence a constructive culture.
- Platform-based organizations must invest in digital talent and promote soft skills and team building to create a culture in which people want to work.

9.3 Big Data Analytics

One of the hottest terms in IT is big data. **Big data** refers to any massive data set that exceeds the boundaries and conventional processing capabilities of traditional IT. Big data requires a nontraditional approach; it requires that managers throw out the old way of thinking and take a totally new approach to data processing. Exhibit 9.3 illustrates how big data are different from regular data.

Big data includes data sets with sizes beyond the ability of traditional software tools to manage and process the data within an acceptable time frame. As described earlier, big data analytics refers to the process of examining large data sets to uncover hidden patterns, correlations, and other useful information and make better decisions. Because the data sets are so massive, big data analytics often cannot be done with existing analytics tools; thus, a new class of big data technology has emerged.

EXHIBIT 9.3
Big Data Is Really Big



Source: Based on Steve Duplessie, "Big Data: A Better Definition," Enterprise Strategy Group blog, January 6, 2012, http://www.esg-global.com/blogs/big-data-a-better-definition/ (accessed December 20, 2014).

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In an era of digital media, businesses and their customers are expecting more from big data. Big data has value for which customers will pay, making it an excellent business proposition. People and companies are attaching sensors to things that have never been measured before. On a personal level, consider what happens when you use a Fitbit. The device's sensors gather data from your movements and activities, including number of stairs climbed, distance walked or run, calories consumed, calories burned, sleep patterns, and total number of steps taken. Most users were unaware of much of these data until they strapped on the sensors within a Fitbit. Fitbit users can access data about their habits which is synced from the device to the user's smart phone or computer. A dashboard allows users to track their progress. Moreover, this kind of health data can be aggregated, and health habits shared with others, such as a health professional or a software health analytics program. Using the aggregated data, a doctor could develop a more thorough picture of a patient's overall health and habits.[29]

In industrial business, the "Industrial Internet of Things" is producing unimagined amounts of useful data. Siemens wind energy business provides an illustration.

IN PRACTICE

Siemens Gamesa

Siemens Gamesa, a leader in the renewable energy industry, maintains the industry's largest amount of historical data in a database growing daily with data collected from over 10,000 wind turbines worldwide. Inside each smart turbine are hundreds of sensors that continuously transmit more than 200 GB of data per day to a state-of-the-art diagnostic center in Denmark. At this center, advanced analytics and 24/7 human monitoring convert raw data into valuable insights.

Siemens Gamesa uses data analytics techniques and experienced personnel to "see" what is happening inside the wind turbines and to understand why it is happening. These data enable Siemens personnel to prevent unscheduled breakdowns. Around 130 analytics experts check data on factors such as vibration diagnostics indicative of potential damage, wind direction, weather, service reports, and the performance of similar models, to determine when and how a turbine should be serviced days, weeks, or months in advance. The predictive capability reduces unplanned maintenance and downtime, adding weeks of profitable production and months to the life of the turbine.[30]

9.3a Big Data Requirements

Exhibit 9.4 illustrates five elements of big data, each of which is discussed in the following sections.

Volume. Big data are *really* big. They are so big they are hard to comprehend. Quintillions of bytes of data are created every day, and as IBM figures it, about 90 percent of the data that exist in the world today were created within the last two years.[31] By the year 2020, the volume of digital data is expected to surpass 40 zettabytes. One zettabyte is 50 percent more than all the grains of sand on all the Earth's beaches—an astronomical amount of information. Data can be collected easily and often without awareness on the part of individuals being recorded. Many automobiles are recording data all the time. Our physical locations have become data. If you start up Google maps on your smartphone, it immediately knows where you are. Even our interactions with each other have become data, say Viktor Mayer-Schönberger and Kenneth Cukier, the authors of a book on big data, who refer to this new phenomenon as the "datafication of everything."[32]

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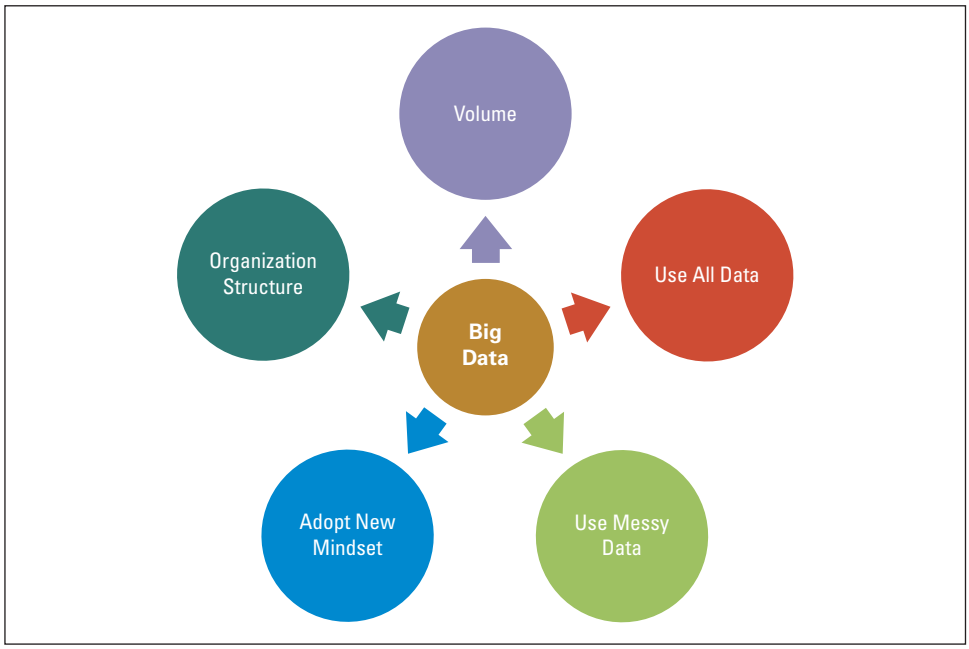
EXHIBIT 9.4
Elements of Big Data Function



Source: Based on Figure 1.1 Cracking the Big Data Nut, in David Loshin, *Big Data Analytics: From Strategic Planning to Enterprise Integration with Tools, Techniques, NoSQL, and Graph* (Morton Kaufmann, 2009), 3.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Change your mindset to take maximum advantage of big data analytics. Learn to use all the data you have, not just a sample. Look for patterns and correlations that might be significant.

If all the data available today were printed in books, they say the books would cover the entire surface of the United States 52 layers thick. Placed on CD-ROMs and stacked up, they would stretch to the moon in five separate piles.[33] We are drowning in data but making them mean something is the challenge. For example, Dell realized there were over seven septillion possible configurations of Dell products on its website. To create a new system of "optimized configuration," the analytics team looked for the most common configurations people were choosing, narrowing the seven septillion down to a couple million, even identifying a few models that could be stocked into pre-configured inventory, saving both Dell and customers time and money.[34] "Storing data, recording data is cheap today," says Radhika Subramanian, CEO of analytics solutions provider Emcien. "Now data is everywhere. Everyone has data. It's like dirt."[35]

Use All Data. Using big data, people and companies can do things that weren't possible with smaller amounts. Rather than using just a sample of their data, companies now have the power to capture and store all the data from their operations, which can lead to interesting correlations. For example, one company found that people who buy small felt pads for the bottom of chair legs to protect their wooden floors are typically good credit risks. An analysis of used cars found that orange cars are half as likely as others to have defects.[36] So what? Managers with a big data mindset embrace these correlations, even if they don't see an immediate underlying cause or purpose. Some correlations prove highly valuable. In *Predictive Analytics*, Eric Siegel talks about how companies use big data to quantify how likely it is that a particular customer will default on a loan, upgrade to a higher level of cable service, or look for another job, for example. Citizens Bank was able to cut losses from check fraud by 20 percent thanks to better data analysis. FedEx can reportedly identify with 65 to 90 percent accuracy which customers are likely to move to a competitor, enabling the company to offer incentives to stay.[37]

Use Messy Data. As the size of data sets increases, so do inaccuracies. Think about a small grocery store, which may count the money in the cash register each night

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down to the last penny. The same couldn't be done for a country's gross domestic product. A devotion to rigid exactness is given up in a big data world; managers are content with a general direction. Big data are often messy, vary in quality, and come from different sources. Because there is less error than from using sampling, though, managers can live with these inaccuracies. Amazon ran a test to see whether personal book recommendations from editorial staff or from data-based computer analyses generated more book sales. The computer analysis won hands-down. Websites collect massive amounts of messy data on customers. By using all the data and looking at correlations, companies such as Amazon, Netflix, eHarmony, LinkedIn, and Facebook can recommend books, products, friends, dates, and groups without even knowing why people might be interested in them.[38]

Adopt a New Mindset. The big data approach requires a new mindset. It requires surrendering to the data. "I was very sad about the editorial team getting beaten," said Greg Linden at Amazon. "But the data doesn't lie, and the cost was very high."[39] One of the earliest encounters many people had with the big data mindset was the 2011 movie "Moneyball." Brad Pitt portrays Billy Beane, the legendary general manager for the Oakland Athletics baseball team, who in 2002 built one of Major League Baseball's winningest teams with one of its smallest budgets. Rather than rely on the intuition of scouts, who would sometimes reject a player because he "didn't look like a major leaguer," Beane relied heavily on data and statistical analysis. If the analysis said an overweight college catcher that nobody else wanted should be a number-one draft pick, Beane went for it. The movie focuses on clashes between the analytics expert and the chief scout and manager, who had a hard time letting go of the idea of making decisions based on intuition and years of experience. Since that time, most other sports teams have adopted big data statistical techniques to some degree for making decisions. This chapter's BookMark describes how the Houston Astros combined data analytics and old-fashioned scouting to come up with a winning team. "There's still a place for [guys with stopwatches or playing hunches], but technology has changed the game forever," said Steve Greenberg, former deputy commissioner of Major League Baseball.[40]

Such clashes are playing out in companies across the world as managers with a big data mindset run up against those who believe decisions should be made based on historical information and manager experience. That might be why many big data supporters start new companies, such as Google's Larry Page and Sergey Brin, Amazon's Jeff Bezos, eBay's Pierre Omidyar, and FlightCaster.com's Bradford Cross. Cross and some friends analyzed every flight over the previous 10 years, matched against historic and current weather data, to predict if a flight in the United States was likely to be delayed. FlightCaster lost its first-mover advantage when a larger firm, FlyOnTime.us, began doing the same thing, and Cross sold his firm to Next Jump, a company that manages corporate discount programs using big data techniques.[41]

2 Big data analytics gets the best results with carefully selected samples of data.

ANSWER: *Disagree.* Big data analytics uses all data, not just samples as in traditional data analysis. By using all the data, the findings are considered more accurate for the entire population. This is a major departure from traditional data collection based on small samples.

ASSESS YOUR ANSWER

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BOOKMARK 9.0 HAVE YOU READ THIS BOOK?

Astroball: The New Way to Win It All

By Ben Reiter

In 2014, the Houston Astros were considered one of the worst baseball teams in the last half-century. Three years later, they were World Series champions. *Sports Illustrated* staff writer Ben Reiter predicted this unlikely accomplishment in a June 30, 2014 *SI* cover story. His subsequent book, *Astroball: The New Way to Win It All*, is a fascinating account of how the Astros got the "scouts" and the "nerds" to work together to engineer one of the greatest turnarounds in baseball history.

SCOUTS OR STATS? YOU NEED BOTH!

After the hit book and movie *Moneyball*, the story of how Oakland As' general manager Billy Beane effectively used sophisticated statistical analysis, other teams grudgingly began hiring "dorks in polos and khakis," as Reiter puts it, to work alongside baseball lifers who had previously ruled the front office as scouts. The problem became one of having old-fashioned scouts in one corner and the analytic nerds in another, each side resenting the other and usually disagreeing about player decisions. The Astros general manager Jeff Luhnow wanted to get scouting and analytics to work together, recognizing that "success is not a matter of man or machine but of man *plus* machine."

- *Let the Scouts Do Their Job!* Luhnow urged scouts to continue making subjective decisions about players and prospects based on their intuition and experience. Then, he encouraged them to collect unique data and share their data and insights with the number-crunchers.
- *But Use the Stats Too!* Luhnow's leading partner in the transformation was Sig Mejdal, a former blackjack dealer and NASA scientist who became head of the Astros' Nerd Cave as the director of decision sciences. One of Mejdal's toughest jobs was making sure the nerds listened to the scouts.
- *Make It a "Stout" Decision.* The Astros developed proprietary software that analyzes every available bit of data on a player or prospect, including scouting reports, to calculate a numerical rating called Stout, for half stats, half scouts. The Stout is an internal metric that makes a decision about a player as simple as the one in blackjack: hit or stay, keep or trade, play or bench.

PUTTING IT ALL TOGETHER

Reiter's story is filled with juicy tidbits on player decisions, such as how shortstop Carlos Correa was an unexpected pick that was made based on reports from scouts rather than nerd number-crunching, how right fielder George Springer was saved from being cut by the statistical analysis, and how third baseman Alex Bregman was "as clear-cut a top pick as any member of their front office had ever experienced" based on a combination of scouting and analytics. Reiter also provides an interesting account of the team chemistry that contributed to success. *Astroball* outlines the key decisions, unexpected incidents, missteps, and strokes of luck that led from the bottom of the pack to a world championship.

Astroball: The New Way to Win It All, by Ben Reiter, is published by Crown Archetype.

9.3b Big Data and Organization Structure

One crucial question concerns how to organize big data activity within the enterprise. Should the function be centralized or decentralized? Should data specialists be located in a central pool or attached to business units or functions? To which existing unit or function should they report? As with many other activities within organizations, there is no "one best way." Exhibit 9.5 illustrates four structural options for setting up a big data operation. Various structural forms may work best depending on the size and type of organization.

Outsourcing. The first option is to outsource analytics activities. This is a popular choice because many companies don't have the knowledge and experience to put together an analytics team. In addition, finding big data scientists and analysts is not always easy. Because big data analysis is such a hot topic, there is a shortage of skilled analysts looking for jobs. Numerous business process organizations (BPOs)

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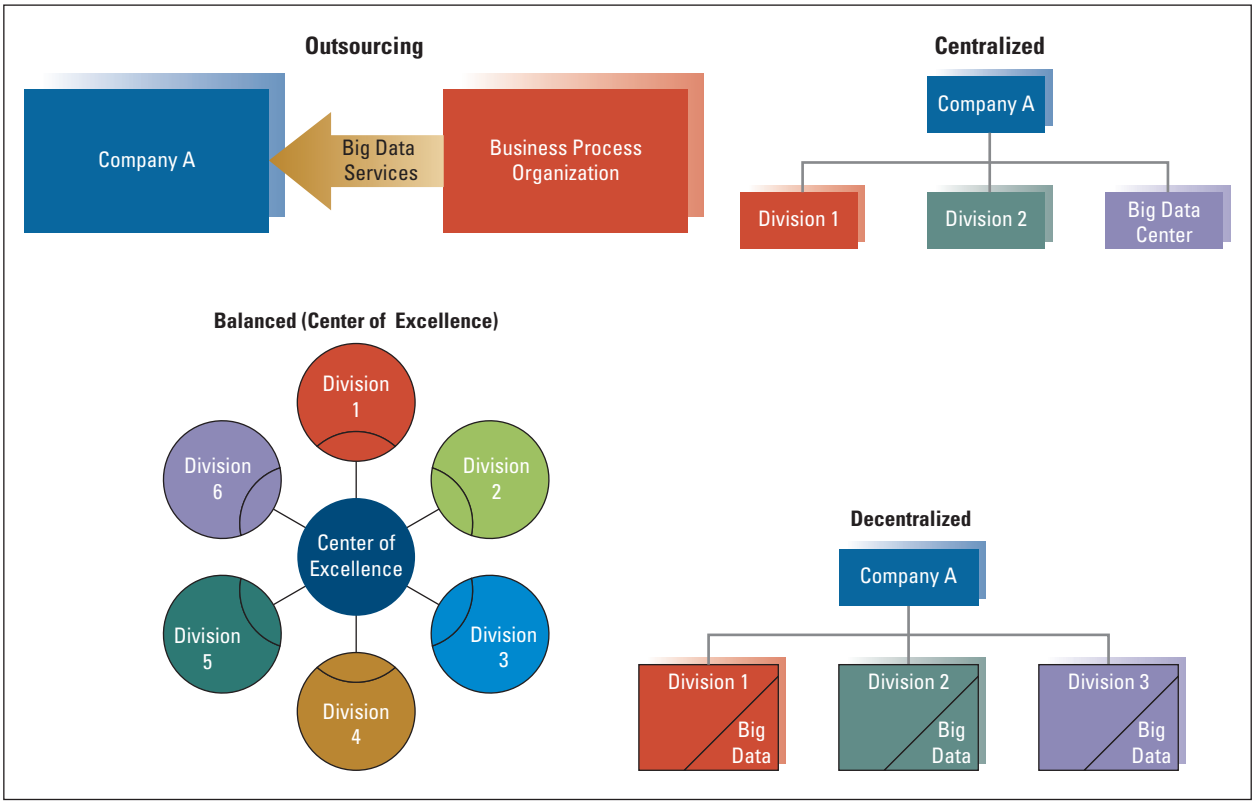
EXHIBIT 9.5
Alternative Structures for Organizing Big Data Analytics



handle call center operations, computer programming, legal research, accounting, and other services for organization, and business analytics is the latest on the menu of services these firms offer. BPOs in India, for example, have highly skilled analytics teams.

One benefit of outsourcing is that it increases flexibility by making fixed costs variable. Setting up an in-house division can be expensive. For companies that don't have in-house capabilities, outsourcing provides a way to quickly obtain the resources to execute analytics projects and gain important insights at a lower cost. In markets where finding workers with analytics skills is difficult, outsourcing might be the only way to get a foothold in big data analytics and achieve an advantage over competitors. The outsourcing firm can often provide resources and training for the company's own employees.[42]

Another form of outsourcing is to use **data intermediaries**, firms that collect data from multiple organizations and analyze the combined data for them.[43] For example, Siemens Gamesa's data center in Denmark can monitor wind turbines for other companies and provide feedback on expected maintenance and repairs. Visa and MasterCard do analysis on the billions of transactions from cardholders in 210 countries to predict consumer and business trends and sell the data to others. A division called MasterCard Advisors discovered that when people fill up their gas tanks at around 4:00 P.M., they are likely to spend between $35 and $50 at a grocery store or restaurant within the next hour.[44]

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BRIEFCASE

As an organization manager, keep these guidelines in mind:

- If you are just starting with big data, consider outsourcing to an organization that has the people, skills, and processes to handle big data analytics effectively and efficiently.
- If you use an in-house unit, use centralized big data to attain a critical mass of experts, achieve efficiency, and share innovations across the enterprise. Decentralize big data if analysts need to work more closely with each division and tailor their models to each division's needs. Use a balanced design with a Center of Excellence to assign a few analysts to specific divisions while the rest remain centralized to work on coordination of organization-wide problems.

Centralized. For companies that want to set up an in-house unit for analytics, the big question is whether to centralize or decentralize. The first in-house model in Exhibit 9.5 centralizes analytics by locating all big data experts in a single department.[45] The advantages are that this achieves a critical mass of analysts and is the easiest way to ensure that the unit can obtain the necessary data and develop the necessary expertise to efficiently test and use various statistical, data-mining, and predictive models. Managers have to decide whether the unit will report to one of the departments, such as finance or marketing, or to a chief data officer (CDO), who reports directly to the CEO. The problem with having a central analytics group report to one of the functions, such as finance, is that applications outside of that function might go unnoticed or unaddressed.[46] Procter & Gamble has had an analytics group since 1992 and as a result is adopting big data analytics ahead of most companies. At P&G, the CIO is currently serving the CDO function by working with the business units to introduce new analytical approaches, and given the company's long history incorporating analytics, this approach seems to be working fine. Intel uses a partnership between the CIO and the chief marketing officer to take the lead in big data analytics. IBM uses an enterprise transformation head who reports to the CEO as the equivalent of a CDO.[47]

Balanced Design. Another in-house approach is to use a balanced or hybrid design, which places a small number of data scientists in a "center of excellence" led by a CDO, while the remainder stay in the various functional departments or business units.[48] The Center of Excellence plays a coordination role, assessing needs, prioritizing projects, and so forth. This might be thought of as a hub and spoke design, such that a team of experts in a central unit is available to provide coordination, answer questions, and provide assistance concerning data analytics to various departments and business units. This design recognizes that each unit has its own analytics priorities, such as strengthening promotional efforts for marketing or optimizing inventory levels for operations. However, it also honors the need for building up analytics expertise that can be applied organization-wide and coordinating the data analytics strategy. An analyst from the center of excellence might be assigned to one of the units for a specific project, which helps to build expertise within the unit.[49] Morgan Stanley recently set up a center of excellence to manage the increasing volume and complexity of data the firm deals with.

IN PRACTICE

Morgan Stanley

Morgan Stanley, like most financial institutions, has amassed tons of data over the years, with more than one petabyte (equivalent to about one million gigabytes) now entering the bank's systems every month.

Marieke Feenstra/Shutterstock.com

To cope with and gain value from the data deluge, Morgan Stanley recently established its Data Center of Excellence, made up of about 30 experts in data architecture, infrastructure and governance. These specialists act as data advisers to the different business and technology divisions within the organization, helping to establish best practices and controls around data quality and security. The team is working closely with Morgan Stanley's AI team, for instance, to make sure algorithms in areas such as commercial real-estate loan analysis or fraud detection are using data that are accurate,

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up-to-date, and complete. The team helped develop an application that allows traders to analyze the risk of a loan without having to do deeper analysis manually. Another system analyzes transactions that can indicate fraudulent behavior. "In the past, you couldn't consume the data in the speed that was needed to get these insights," said Katherine Wetmur, Morgan Stanley's international CIO, who leads the Data Center of Excellence team. Wetmur and other Morgan Stanley leaders believe the center of excellence approach can help the firm more effectively manage and use data as a strategic asset.[50]

Another large organization that uses the center of excellence idea is General Electric. GE launched its big data initiative called the Industrial Internet in 2009. By May 2011, GE had embedded thousands of sensors in power plants, jet engines, utilities companies, oil rigs, and medical systems. Connecting hundreds of thousands of sophisticated sensors to one another gave GE a strategic advantage from its new capabilities. However, prior to 2011, the company's digital technology efforts were scattered. The various businesses employed thousands of software professionals but there was no overarching strategy guiding their technical choices and commercial offerings. Each business unit made choices according to local conditions and each used a different technology. A group of senior leaders found 136 data products across the businesses and only 17 were profitable. GE managers decided to bring the data scientists together in a global center of excellence that would serve all businesses equally.[51]

Decentralized. This approach totally decentralizes data analytics, so that data scientists are spread throughout the organization, with a small group of analysts in each department or business unit. The fully decentralized approach is the easiest way for analysts to collaborate with the respective departments or business units and tailor their models to each unit's needs, but it makes it difficult to share innovative solutions across unit boundaries and achieve critical mass on organization-wide problems and opportunities. Siemens Corporation, for example, created the Siemens Digitalization Program to make it a world leader in combining the physical and digital worlds. Siemens went in the opposite direction of GE, reasoning that its corporate strategy was based on the specific offerings of the business units. Leaders feared the business units would lose their influence with customers if Siemens took a centralized digital approach. Business units were encouraged to build on their own digitalization ideas rather than have top-down mandates. However, Siemens leaders also understand that, with a smaller data analytics group in each business, there is the question of whether each group will have the expertise needed to obtain the necessary data and deploy the appropriate analytical models.[52]

Caesars Entertainment also wrestled with this question and went from decentralized to centralized analytics to increase efficiency and effectiveness of the big data analytics function. At Caesars, with more than 70,000 employees and casino resorts on four continents, data analytics is used not only to understand customers and create a richer customer experience at each property but also to improve operations—everything from food and beverage analytics to human resources analytics. At one time, each Caesars property had its own analytics team of three or four people, but executives believed greater centralization was needed to reap the benefits of data analytics. Centralizing analytics at Caesars has given all the operations a uniform view of their business and a common language across the organization. The centralized team provides support to each of the businesses and facilitates innovation across different areas of the organization and through partnerships outside the organization.[53]

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REMEMBER THIS

- Big data analytics, a direct outgrowth of earlier business intelligence applications, uses digital technologies to examine huge data sets to uncover hidden patterns, correlations, and other useful information and make better decisions.
- Elements of big data are its massive volume, the potential to use all the data rather than just samples, the use of "messy" data, and the need for a new mindset.
- Some companies outsource big data activities to business process organizations or use data intermediaries, because it is tough to build big data capabilities in-house. As more people gain the skills, however, more organizations are building their own big data analytics departments.
- Companies can choose to centralize big data activities, decentralize big data to departments or divisions, or use a Center of Excellence.

9.4 Artificial Intelligence

Much of the power underlying the smart factory, platform-based organizations, and big data is the software known as **artificial intelligence**. With the ability to make decisions equal to or better than human beings, computer-based artificial intelligence (AI) is being rapidly adopted in organizations' core manufacturing technologies. Exhibit 9.6 defines AI and some of the other new technologies being used in today's organizations. AI is also creeping into aspects of organization management. For example, new software is automating mundane office tasks in operations such as accounting, billing, payments, and customer service. AI programs can scan documents, check the accuracy of customer records, enter numbers into spreadsheets, and make payments. Another application is to check on expense account fraud. Manual expense account audits may be a thing of the past as computers use AI to eliminate questionable write-offs such as wine at lunch or a round of golf. These office work applications are just beginning, and the AI systems will continue to learn as they go. For now, most office applications focus on menial, routine tasks that free workers from the drudgery jobs.[54]

Even more AI progress has been made in HR recruiting and hiring. IBM is using its own AI platform called Watson Candidate Assistant, for example, to infer specific skill sets from the roles listed on a candidate's resume. If work on an advertising campaign over the past year is listed, Watson infers that the work involved digital marketing skills. The technology then presents the candidate with several job opportunities based on the identified skills. Candidates receive opportunities to apply for jobs they may never have thought of. Watson continually learns from the three million job applications IBM receives annually. The technology knows the specifics of IBM's jobs in 170 countries, understands the skills needed for each, and maps that knowledge onto the data coming in from job applicants. Watson Recruitment, another AI tool, helps IBM prioritize resumes for recruiters without considering personal details like age or gender.[55]

Unilever is also using AI in the HR function. Unilever is using algorithms to replace personal resumes. For a job applicant, the first three rounds of interviews and assessments—filling out the job application, playing a set of online games, and submitting a video of oneself responding to questions—do not involve a Unilever

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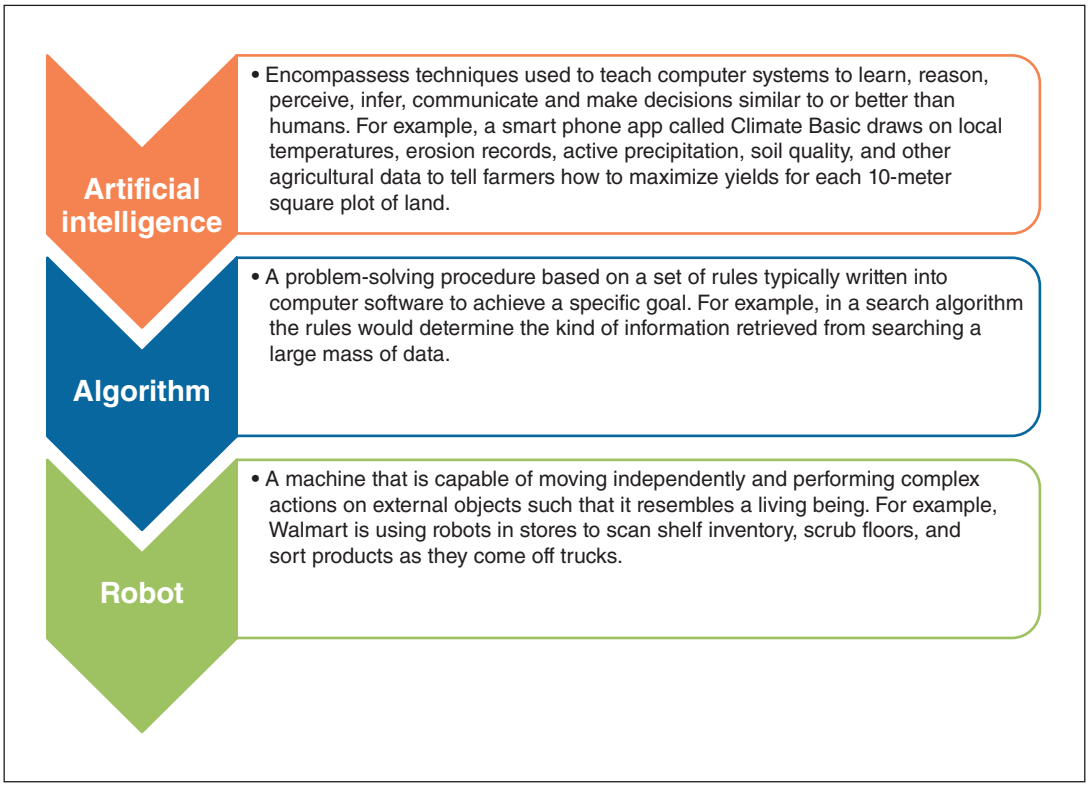
EXHIBIT 9.6
New Information Technologies Used in Organizations


Artificial intelligence
• Encompassess techniques used to teach computer systems to learn, reason, perceive, infer, communicate and make decisions similar to or better than humans. For example, a smart phone app called Climate Basic draws on local temperatures, erosion records, active precipitation, soil quality, and other agricultural data to tell farmers how to maximize yields for each 10-meter square plot of land.
Algorithm
• A problem-solving procedure based on a set of rules typically written into computer software to achieve a specific goal. For example, in a search algorithm the rules would determine the kind of information retrieved from searching a large mass of data.
Robot
• A machine that is capable of moving independently and performing complex actions on external objects such that it resembles a living being. For example, Walmart is using robots in stores to scan shelf inventory, scrub floors, and sort products as they come off trucks.

Source: Based on Jackie Snow, "An A. I. Glossary," *The New York Times*, October 18, 2018, F3; John McCormick, "Test Your Knowledge of Artificial Intelligence," *The Wall Street Journal*, April 1, 2019, https://www.wsj.com/articles/test-your-knowledge-of-artificial-intelligence-11554136673; and Anand Rao, "A Strategist's Guide to Artificial Intelligence," *Strategy+Business*, May 10, 2017, https://www.strategy-business.com/article/A-Strategists-Guide-to-Artificial-Intelligence?gko=d2e2b.

employee. An applicant meets a hiring manager only when recommended by an algorithm. AI software and algorithms do most of the hiring work. Goldman Sachs and Walmart's Jet.com are testing similar digital hiring tools.

Unilever places ads on Facebook and other targeted websites. Applicants can apply in just a few clicks. An algorithm scans the applications to identify appropriate candidates, thereby weeding out more than half of the pool. Candidates then play a set of 12 short online games to assess skills such as concentration and short-term memory. At this point, 60 to 80 percent of candidates are eliminated. AI also assesses how quickly people respond to questions, their facial expressions, and vocabulary. The final step is an in-person interview with a human resource manager. Unilever says hiring is faster and more accurate using AI, because 80 percent of applicants who make it to the final round get job offers and 80 percent accept.[56]

9.4a Is AI an Objective Decision Maker?

Three researchers at the University of Toronto built a system that could analyze thousands of photos and teach itself to recognize everyday objects, such as flowers, cards, and dogs. The system was so effective that Google bought the small startup company. The system sparked a technological revolution. Machines suddenly could

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"see" in a way not possible previously. This accelerated the progress of driverless cars and other robotics that needed to see more like a human being. It also improved the accuracy of facial recognition services that could be used for social networks such as Facebook or for law enforcement agencies.[57]

With its relentless focus on facts, AI seems to overcome a typical supervisor's prejudices. However, AI can have its own biases, such as favoring job candidates who have characteristics similar to those the software has seen before. Researchers soon noticed that facial recognition services were less accurate when used with women and people of color. Prominent AI researchers from Microsoft, Google, and several top universities and other organizations signed a letter calling on Amazon to stop selling its facial-recognition technology to law enforcement agencies because the software was biased against women and people of color. In one academic publication that tested facial-recognition software, the software mistook women for men 19 percent of the time, and misidentified darker-skinned women for men 31 percent of the time. In another example, a major company built a job-applicant screening program that automatically rejected most women's resumes. Another company developed facial-recognition algorithms that mistook many black women for men. Broader evidence of bias came in a 2018 study of three facial-recognition tools of the kind used by law-enforcement agencies to find criminal suspects or missing children. Analyzing a diverse sample of 1,270 people, the programs misidentified up to 35 percent of darker-skinned women as men, compared with the top error rate for white-skinned men of only 0.8 percent.[58]

This bias may arise because developers testing their products often rely on data sets that lack adequate representation of minority groups or women. One widely used data set, for instance, is more than 74 percent male and 83 percent white. When engineers test algorithms on these data sets that contain primarily people like themselves, the results tend to be accurate. Moreover, although companies have stepped up efforts to recruit women and minorities, computer and software professionals who write AI programs are still largely white and male. Subtle unconscious biases may be built into some AI algorithms right from the start if developers are not consciously thinking about racial and gender differences.[59]

One solution would be for developers to increase racial and gender diversity on their design teams. The value of team diversity is illustrated by Microsoft, which recruits employees with diverse creative and artistic skills to help write programs that interact with human beings. Team members have included a playwright, a comic-book author, a songwriter, an essayist, a novelist, and a philosophy major. The diversity and professional skills equipped the teams to write appropriate language and anticipate diverse user reactions.[60]

ASSESS YOUR ANSWER

3 Artificial intelligence is objective and bias-free compared to human decision making in organizations.

ANSWER: *Disagree.* It seems as if AI would overcome a typical supervisor's prejudices, but AI can have its own biases that are built into the decision-making software. Developers testing their products often rely on data sets that lack adequate representation of minority groups or women. Subtle unconscious biases may be built into some AI algorithms right from the start if developers are not consciously thinking about racial and gender differences.

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9.4b Is Nudge Management Going to Be Your Coach?

Imagine you are sitting down for morning coffee with your management coach or mentor. You review your goals in your new job as a manager and wonder whether you are spending your time wisely. The coach provides tips on your smart phone in 5- to 10-minute videos that you watch in spare moments during your workday.

Your coach in this situation is a manager-training web-robot powered by artificial intelligence in IBM's Watson. The coach's name is Amanda. One coaching mini-assignment might be to ask more questions rather than "telling" associates what to do. The instruction might be "see if you can go a whole day and manage only by asking questions. Think of it like a secret game you are playing. Instead of telling or giving an idea, how can you have an effect through questions? If someone asked for your opinion, ask back, 'What do you think?' If someone wants you to decide something for them, ask, 'What would you do if you were me?'"[61] When a manager recently texted that she doubted her ability to review a colleague's performance, the web-robot coach chided her for being too hard on herself, based on the manager's personality trait score of being highly conscientious. Coach Amanda helped another manager run a richer brainstorming session by suggesting he ask more questions. Many managers like taking their training on the job, right when they need it, rather than in formal classes. At Fidelity Investments, this kind of coaching AI software is helping employees and managers give and receive feedback more easily. If the AI software identifies a morale problem, such as a feeling among employees that the manager's decisions are being made too secretively, the manager might be texted to explain his decisions more clearly. At the same time, employees might get messages aimed at restoring trust in the manager by suggesting he or she has good intentions and is really busy.[62]

AI coaching programs use the concept of **nudge management**, which applies insights from the behavioral sciences to offer gentle reminders, or nudges, toward desired behaviors, such as a reminder to seek a person's attention or urge an action.[63] Nudge management is about improving an individual's decision-making with regard to health, wealth, happiness, and goal achievement. Nudge management theory is based on the economist Richard Thaler's Nobel Prize-winning research into how people make decisions based on what is easier rather than on what is in their best interest. A well-timed nudge can prompt a person to make better decisions. For example, by employing nudge management employees may be made aware of their own distracting and often unconscious actions such as constantly checking e-mail, web browsing, social media, and so on. Software can detect these patterns and perhaps change the default settings in the e-mail software to turn off the sound effect of an incoming e-mail or only allow access to the e-mail inbox once every hour.[64]

Google tries to nudge workers toward happiness. Google's nudge system, for example, helps remind employees to be the person they want to become. One manager said the bite-size reminders made it easy to take action right away when he was prompted to ask members of his team for their opinions before he made a decision. Another manager might be reminded to hold one-on-one meetings with staff members to discuss development goals.[65]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Use artificial intelligence to take over routine organizational tasks. Delegate greater responsibility to the remaining employees doing nonroutine tasks. Use AI as a management coach whenever possible. Be cautious about relying too heavily on AI to oversee and control employees, and never let an algorithm evaluate or fire an employee without human contact.

9.4c Algorithmic Control May Be Your New Boss

Artificial intelligence has the potential to solve some of the world's toughest problems, such as reducing automobile deaths and helping doctors diagnose

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diseases. Data and algorithms are presented as objective, neutral, even benevolent helpers. The algorithms give us convenient food delivery services, personalized movie recommendations, and determine the news we see on Facebook. Moreover, AI has the potential to perform routine tasks so that more nonroutine work can be decentralized to humans in the form of greater responsibility and work that is more satisfying.

However, there is another side to the story. When employees do work that is measurable and somewhat routine, AI can assert a level of control over workers that is fine-grained down to minor details. **Algorithmic control** is the use of software algorithms to set targets, measure performance, provide feedback, and decide rewards for employees. Seemingly, there may be no place for an employee to hide from algorithmic control. UPS governs the working life of a delivery truck driver with a handheld device and more than 200 sensors on each delivery truck that track everything from seat belt use, to backup speeds, to stop times. When a driver stops and scans a package for delivery, the system records the time and location and when a customer signs for the package. Much of this information goes to a supervisor in real time.[66] Uber and other ride-hailing apps use algorithms to watch everything a driver does. Personal statistics are comprehensive, including riding acceptance rates, cancellation rates, hours spent logged in, acceleration smoothness, trips completed, and passengers' ratings of their performance. Selected statistics are displayed to drivers as motivating tools, with messages such as, "You are in the top 10 percent of partners!" In addition, if drivers fall below 4.6 stars on a 5-star rating system, they may be deactivated.[67] Some companies are giving employees ID badges to wear. The badges track employees' movements through the office and record with whom they talk and how long they spend in conversation. A survey from the American Management Association found that 43 percent of employers monitor employee e-mail, 45 percent track employee keystrokes, and 66 percent monitor the Internet use of their employees.[68]

At its worst, AI can be used to evaluate and fire an employee without human contact. Documents obtained by *The Verge* claimed to show how Amazon used a computer system to automatically track and fire hundreds of fulfillment center employees for failing to meet productivity quotas. Is this a grim glimpse into the future in which AI is your boss? The documents indicated that Amazon's system tracks the rates of each associate's productivity and automatically generates any warnings regarding quality or productivity, as well as terminations, without input from supervisors. It is not clear whether Amazon still uses this system. An Amazon spokesperson said Amazon would never dismiss an employee without first ensuring the employee had received support and coaching to help improve and emphasized that Amazon's objective is to provide long-term career development. An anonymous employee wrote a piece for *The Guardian* that claimed workdays at Amazon are managed down to the second. Employees say they feel they are treated like robots when they are so comprehensively measured by digital trackers and indicators in these automated systems.[69]

Why are organizations using algorithms for such intense control? Because it pays off financially by reducing employee variability and slack. UPS in some cases has added 10 stops to a driver's workday. Drivers who are not up to standard at Uber can be identified and deactivated. The new algorithmic control systems produce impressive results for the bottom line. After United Grocers, a large wholesaler, implemented an electronic tasking system for its warehouse workers, the firm was

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able to cut payroll expenses by 25 percent while increasing sales by 36 percent. A study of chain restaurants found that electronic monitoring decreased employee theft and increased hourly sales.[70]

9.4d AI Implications for Organization Design

The rapid growth of artificial intelligence applications in organizations suggests two adjustments to organization design: 1) create a new senior AI position and 2) decentralize authority to employees doing nonroutine work.

Add a Chief Artificial Intelligence Officer. Creating a position in the organizational hierarchy for a senior AI specialist may help organizations deploy the technology more effectively. A handful of companies have introduced the new role of chief artificial intelligence officer (CAIO) to help move this evolving technology beyond the initial stages. Companies that have hired AI chiefs, such as Toronto-Dominion Bank Group, say the executive works across organizational boundaries and spots new areas where AI can improve the business. The CAIO defines strategies, coordinates projects, and recruits hard-to-find data scientists and other AI experts. Some forward-thinking companies want an AI officer to be at the table when discussing what the future looks like. As one CAIO explained, "Everyone expects AI to be the most transformative technology of our generation. It is going to completely change how our business operates. The role I play is one of managing the disruption."[71]

One important application of AI strategy at Toronto-Dominion Bank is developing a predictive model for the mortgage business. The model analyzes credit bureau data, account and transaction data, demographic information, and data from other sources to spot banking clients who are likely thinking of buying a home. Once a potential mortgage client is identified, a bank representative will reach out to the person to discuss next steps to begin the loan process. The model can predict very early on when customers might be in the process of buying a home. Reaching out to show interest in a potential borrower is much more effective than waiting at the branch for them to show up wanting to complete a mortgage application.[72]

Decentralize Authority. With respect to the organizational hierarchy, AI can be expected to take over many routine tasks, so much of the remaining nonroutine work is likely to be accomplished by loosely governed decentralized groups of people with a combination of skills needed for whatever problem arises. In an automobile plant, for example, robots already do much of the routine physical work that used to be done by people. In the not-too-distant future, robots may be doing all the routine work. The job of humans is becoming primarily one of designing new vehicles and production processes, repairing the machines, and dealing with other nonroutine problems that arise during daily operations. People who do nonroutine work do not need to be managed the same way as traditional factory workers. Like employees in consulting firms and research organizations, nonroutine employees often know better than their managers what needs to be done and how to do it. Nonroutine employees are best managed with the freedom to do their work. Complete the questionnaire in the "How Do You Fit the Design" box to see how your work habits align with greater decentralization and autonomy. People who do the nonroutine work might be organized into something resembling a team holacracy rather than a traditional organizational hierarchy.[73]

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HOW DO YOU FIT THE DESIGN?

HOW WILL YOU HANDLE DECENTRALIZATION AND AUTONOMY?

As machines take over more routine work, and digitalized organizations decentralize the remaining nonroutine work, do your work habits include making your own plans and setting your own goals? Answer the following questions as they apply to your work or study behavior. Please answer whether each item is Mostly True or Mostly False for you.

	Mostly True	Mostly False
1. I set clear, specific goals in more than one area of my work and life.	_____	_____
2. I have a definite outcome in life I want to achieve.	_____	_____
3. I prefer general to specific goals.	_____	_____
4. I work better without specific deadlines.	_____	_____
5. I set aside time each day or week to plan my work.	_____	_____
6. I am clear about the measures that indicate when I have achieved a goal.	_____	_____
7. I work better when I set more challenging goals for myself.	_____	_____
8. I help other people clarify and define their goals.	_____	_____
9. Trying for specific goals makes life more fun than being without goals.	_____	_____

Scoring: Give yourself one point for each item you marked as Mostly True, except items 3 and 4. For items 3 and 4 give yourself one point for each one you marked Mostly False. If you scored 4 or less, goal setting behavior may not be natural for you. A score of 6 or above suggests a positive level of goal setting behavior and better preparation for a decentralized role in a digital organization.

Interpretation: An important part of digitalized organization life is setting goals, measuring results, and reviewing progress for yourself and others. The preceding questions indicate the extent to which you have already adopted the disciplined use of goals in your life and work. Research indicates that setting clear, specific, and challenging goals in key areas will produce better performance. Not everyone thrives in a decentralized organization, but as an organization employee or manager, setting goals, assessing results, and holding yourself or others accountable will enhance your impact. Goal setting can be learned.

REMEMBER THIS

- Artificial intelligence encompasses techniques used to teach computer systems to learn, reason, perceive, infer, communicate and make decisions similar to or better than human beings.
- AI is having a big impact on the administrative processes in organizations, including spreadsheets, checking customer records and employee expense accounts, and making payments.
- Even more progress has been made in HR recruiting and hiring. Companies such as IBM and Unilever use algorithms for the first few rounds of job candidate interviews.
- AI may not be as objective as it appears. Managers should be alert for bias toward minority groups.
- AI has excellent potential for coaching managers and other employees through nudge management.
- Algorithmic control systems can measure every aspect of routine work to seemingly gain more work from employees with the loss of employee autonomy.

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9.5 Other Digital Applications in Organizations

Organizations are also using a variety of other digital information technologies to improve coordination, collaboration and knowledge sharing among employees, to enhance efficiency and effectiveness, and to add strategic value. Social network analysis and knowledge management are important elements of the digitalization of organizations.

9.5a Social Network Analysis

A valuable technique enabled by IT is called **social network analysis** (SNA), which can help managers learn about informal relationships and network structures within an organization. With SNA they can know who has influence and who doesn't, who people turn to for answers, who has the knowledge and technical capability to be innovative, and who has leadership potential. SNA was developed by scientists as a social theory to diagram relationships among people that differ from the formal hierarchy. A large petroleum organization conducted an SNA and found a striking difference between the formal structure defined by hierarchical reporting relationships and the way in which information actually flowed through the organization.

IN PRACTICE

Exploration and Production Division

The deep-sea drilling industry is highly competitive and highly capital-intensive. Executives knew they could reap huge cost savings if every platform could drill as quickly and cost-efficiently as the company's best. The question was whether people were effectively sharing knowledge and best practices. A first step in a social network analysis was to map the interactions for the top 20 executives in the Exploration and Production Division (E&PD). The results were surprising.

The SNA revealed that in the informal information flow there was a complete separation with no communication between the Production Department and the Drilling Department, and only a single manager who linked the Production Department with the Exploration Department in the information flow. In other words, the actual information flow was not sufficient to meet the need for coordination. The mapping also found that the senior vice president was relatively peripheral to the flow of information. Interviews with managers and further investigation provided insight into how the E&PD could more effectively manage the flow of information and knowledge-sharing.[74]

As this example shows, the structure as defined by the informal information flow may be very different from the formal organization structure as defined by the hierarchy. Social networks include people who turn to one another for help, advice, information, and support, whether or not they are in the same work group. It is within these networks that much of an organization's work gets done.[75] "There is a secret structure at every organization that spells success or failure. You can't see it in the org chart or in the flow of money on the spreadsheet. But within this [informal] structure, the assistant in the third cubicle from the elevator may be more crucial than the suit in the fancy corner office," says corporate anthropologist Karen Stephenson.[76]

People play different roles in social networks. Three roles, or patterns of relationships, seen over and over in organizations are the hub, the broker, and the peripheral player. *Hubs* are people who are at the center of an information network. These are people who are sought out for their knowledge and information. Hubs

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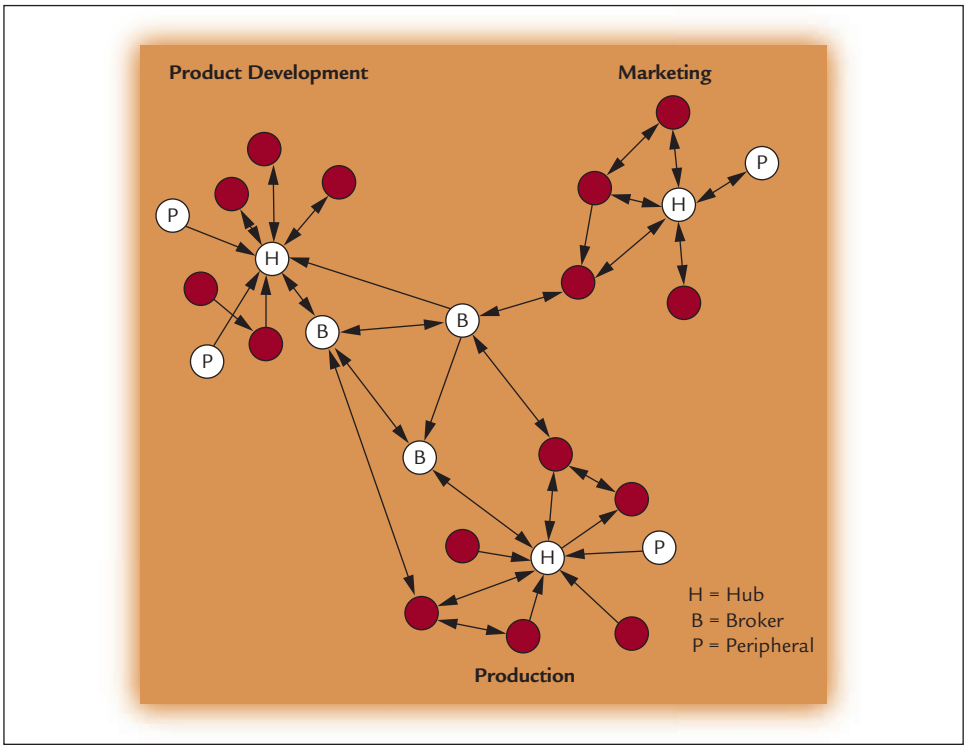
tend to have more influence than other employees. They may have technical expertise and organizational memory, as well as a set of relationships that helps them get information that other people need. Hubs are the "go to" people in an organization. If they don't know the answer, they know where to find it. A long-time salesperson might be a hub because he or she has developed connections with other salespeople as well as with clients, managers, and people in other departments, and has years of knowledge about how the organization works. *Peripheral players* have the fewest number of connections and operate on the boundaries of a network. They are marginal players, but they can still be important because they may have niche expertise or valuable outside contacts. These might not be needed on a daily basis but could be useful during a crisis or for specialized projects. Of particular importance are the *brokers*, the people who have a knack for connecting people across boundaries and subgroups.[77] Brokers link specialized pools of knowledge and integrate the larger network within the organization. For example, a well-known investment bank won the business of a major account from a rival bank thanks to David Hawkins, a manager who played a broker role. The client had been with the rival bank for years. However, Hawkins had connections to different product and service groups within his bank that the executive at the rival bank didn't have within his firm. Hawkins served as a link across his bank's groups and introduced the client to them, which enabled his bank to create a more targeted and customized financial solution that met the client's unique needs.[78]

Exhibit 9.7 illustrates the three roles in a hypothetical organization, showing how the broker connects different parts of the larger network. Understanding these informal networks offers a competitive advantage to a company. By knowing who is facilitating high performance in others, who is collaborating, and who has personal connections, managers have a tool through which to help the company improve,

EXHIBIT 9.7
Roles in a Social Network



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innovate, expand, and grow.[79] IBM has been using SNA for years. SNA experts work with companies to find their hidden networks by asking employees simple questions like the following:

"To whom do you go for a quick decision?"
"Whom do you hang out with socially?"
"To whom do you turn for advice?"
"Whom do you go to with a good idea?"
"To whom do you go for career advice?"[80]

SNA can be administered in the form of an electronic employee survey or by tracking e-mail messages among employees. Here are some examples of information that a sophisticated network tracking system might provide:

- Who is working with whom in the company's social network?
- Who are the informal leaders, and who has leadership potential?
- How does knowledge and information flow through an organization?
- Who is being overutilized, and who is being underutilized?
- Who are the experts in a company before they retire so their knowledge can be stored or transferred?[81]

Social network analysis can uncover hidden workplace relationships. It offers clear delineation of relationships through data, facts, and statistics instead of relying on rumor and innuendo. These data can be used to change the organization. For example, after reviewing the results of the SNA, the packaged food company Mars found that people in the snack food division in New Jersey weren't talking enough with peers in the Los Angeles food division, creating duplication of work and missing opportunities for collaboration and information sharing. Now Mars builds in ways for colleagues on both coasts to keep in touch with each other, and their performance reviews are based in part on their informal networking activities.[82]

Sometimes a stronger intervention is needed to change networking patterns. A global consulting organization discovered that two subgroups had formed based on technical and nontechnical skills. Clients needed a combination of "soft" strategy and organizational design smarts combined with "harder" technical knowledge. The split between the two groups came about because individuals gravitated toward each other based on common work-related and professional interests, attending the same conferences, and time spent working together. With guidance from management, each subgroup learned what the other group offered to clients. The groups were brought together to discuss the situation, which ultimately led to changes in how the groups operated. These changes promoted knowledge sharing and collaboration. The final result of collaborative groups gave the consulting company a distinct advantage that resulted in more sales and happier clients.[83] Systematic manager interventions based on SNA can help a company build a healthy pattern of informal relationships that replace ad hoc dysfunctional relationships.[84]

9.5b Knowledge Management

One important outcome that can begin with SNA is to improve an organization's knowledge management. **Knowledge management** refers to the efforts to systematically find, organize, and make available a company's intellectual capital and to foster a culture of continuous learning and knowledge sharing.[85] The company's **intellectual capital** is the sum of its knowledge, experience, understanding, relationships, processes, innovations, and discoveries.

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Knowledge management is supported when people have ways to share information and ideas and are rewarded for doing so. A common form of corporate information sharing is an **intranet**, a private, companywide information system that uses the communications protocols and standards of the Internet but is accessible only to people within the company. To view files and information, users simply navigate the site with a standard web browser, clicking on links. Intranets can improve internal communications and unlock hidden information. They enable employees to keep in touch with what's going on around the organization, quickly and easily find information they need, share ideas, and work on projects collaboratively.

Companies need ways to transfer both codified knowledge and tacit knowledge among people across the organization.[86] **Codified knowledge** is formal, systematic knowledge that can be articulated, written down, and passed on to others in documents, rules, or general instructions. Tacit knowledge, on the other hand, is often difficult to put into words. **Tacit knowledge** might include how to interpret the look on a negotiator's face or the learned experience of working with a client over a long period of time. It is based on personal experience, rules of thumb, intuition, and judgment. It includes professional know-how and expertise, individual insight and experience, and creative solutions that are difficult to communicate and pass on to others. As much as 80 percent of an organization's valuable knowledge may be tacit knowledge that is not easily captured and transferred.[87] With about 10,000 baby boomers reaching retirement age every day, some large traditional companies are looking for ways to stem the loss of all the "tribal knowledge they are taking with them" as they go.[88]

IN PRACTICE

BAE Systems

A manager at BAE Systems recently demoted himself. As he moves toward retirement, he now works as an assistant to a young employee who joined the company from the U.S. Navy to do the job the manager once held. The two have been meeting regularly for some time, talking about various projects, exchanging advice, and sharing tips. They worked together on a bid to handle maintenance and repairs on an amphibious ship for the Navy. The older manager had managed that contract for 11 years, but when it was renewed this time, he handed the project over to the newer employee and demoted himself to assistant.

Chris Ison/PA Images/Getty Images

It's all part of BAE's plan to keep the multinational defense and aerospace company from losing the tacit knowledge residing in the heads of thousands of retiring employees. When BAE learns that an employee with deep organizational knowledge plans to retire, the company forms a knowledge-transfer team made up of people of varying ages working in the same area. Creating relationships between older and younger employees is an effective way to capture tacit knowledge and manage the transfer of leadership to Millennials, says Andrew Muras, BAE's advanced learning manager. Vikram Ravinder, a 29-year-old Deloitte consultant who has worked with a retiring mentor, agrees. "Millennials bring data and analytics," Ravinder said, "but boomers have experience they can rely on when the data isn't sufficient."[89]

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Other companies are also striving to find ways to prevent the loss of tacit knowledge as employees retire or leave the organization. Organizations also want to create knowledge management practices that encourage ongoing knowledge sharing. Two approaches to knowledge management are outlined in Exhibit 9.8.[90] The first approach deals primarily with the collection and sharing of codified knowledge, largely through the use of sophisticated IT systems. Codified knowledge may include intellectual properties such as patents and licenses; work processes such as policies and procedures; specific information on customers, markets, suppliers, or competitors; competitive intelligence reports; and benchmark data. The second approach focuses on leveraging individual expertise and know-how—tacit knowledge—by connecting people face to face or through interactive social media. Tacit knowledge includes professional know-how, individual insights and creativity, and personal experience and intuition. With this approach, managers concentrate on developing personal networks that link people together for the sharing of tacit knowledge. The organization uses IT systems primarily for facilitating conversation and person-to-person sharing of experience, insight, and ideas. Some companies use **expert-locator systems** that identify and catalog experts in a searchable database so people can quickly identify who has knowledge they can use.[91]

Encouraging and facilitating the sharing of tacit knowledge isn't easy. Despite the fact that companies have spent billions on software and other technology for knowledge management, there is some indication that knowledge sharing has fallen short of managers' goals. For instance, 60 percent of employees surveyed by a Harris poll said work was often duplicated in their organizations because people were unaware of one another's work. Fifty-four percent said their companies missed opportunities to innovate because of poor collaboration and information sharing, and 51 percent said managers regularly made poor decisions because employee knowledge isn't effectively tapped.[92] For example, through conversation and ongoing interaction, salespeople often come to know what top executives in a client's organization want in a product or service. With this tacit knowledge, the salespeople could help develop

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Establish systems to facilitate both codified and tacit knowledge sharing among employees to help the organization learn and improve. Use social network analysis to learn about informal relationships and patterns of influence.

EXHIBIT 9.8
Two Approaches to Knowledge Management

Knowledge Management Strategy	Codified	Tacit
	Provide high-quality, reliable, and fast information systems for access of explicit, reusable knowledge	Channel individual expertise to provide creative advice on strategic problems
	People-to-documents approach	**Person-to-person approach**
	Develop an electronic document system that codifies, stores, disseminates, and allows reuse of knowledge	*Develop networks for linking people so that tacit knowledge can be shared*
Information Technology Approach	*Invest heavily in information technology, with a goal of connecting people with reusable, codified knowledge*	*Invest moderately in information technology, with a goal of facilitating conversations and the personal exchange of tacit knowledge*

Source: Based on Morten T. Hansen, Nitin Nohria, and Thomas Tierney, "What's Your Strategy for Managing Knowledge?" *Harvard Business Review*, March–April 1999, 106–116.

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better solutions for the client, refine their firm's marketing message, and increase their company's revenue. Yet many organizations lack the internal information-sharing networks to tap into this tacit knowledge. Salespeople naturally concentrate on forming networks with customers and potential customers, not with people inside the company.[93] Managers should understand and manage internal information networks so that tacit knowledge can be shared more easily.

REMEMBER THIS

- Two important elements of the digitalization of organizations are social network analysis and knowledge management.
- Managers can use social network analysis to increase coordination and collaboration. Social network analysis helps managers identify the hubs of informal information exchanges within the organization and the informal leaders who serve to connect people and groups across organizational boundaries.
- Managers also use intranets and other digital IT systems to promote the sharing of both codified and tacit knowledge.

9.6 Digital Impact on Organization Design

Managers and organization theorists have been studying the relationship between technology and organization design and functioning for more than half a century. As we mentioned in Chapter 8, IBM's CEO Study found that technology topped the list of external forces executives expect to significantly influence their organizations over the next few years.[94] In recent years, the advances in digital IT have had the greatest impact in most organizations.[95] Some specific implications of these advances for organization design are smaller organizations, decentralized structures, improved internal and external coordination, and new network organization structures.

1. *Smaller organizations*. Some Internet-based businesses, such as the platform-based organization form we discussed earlier, exist almost entirely in cyberspace; there is no formal organization in terms of a building with offices, desks, and so forth. One or a few people may maintain the site from their homes or a rented work space. Even for traditional businesses, digital IT enables the organization to do more work with fewer people. Customers can buy insurance, clothing, tools and equipment, even cars over the Internet without ever speaking to an agent or salesperson. In addition, new digital systems automatically handle many administrative duties within organizations, reducing the need for clerical staff. The Michigan Department of Transportation (MDOT) used to need an army of workers to verify contractors' work. Large projects often required as many as 20 inspectors on-site every day to keep track of thousands of work items. Today, MDOT rarely sends more than one field technician to a site. The employee enters data into a laptop computer or digital device using road construction management software tied to computers at headquarters. The system can automatically generate payment estimates and handle other administrative processes that used to take hours of labor.[96] Thanks to IT, today's companies can also outsource many functions and thus use fewer in-house resources.

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2. *Decentralized organization structures.* Although management philosophy and corporate culture have a substantial impact on whether IT is used to decentralize information and authority or to reinforce a centralized authority structure,[97] most organizations today use technology to further decentralization. With digital IT, information that may have previously been available only to top managers at headquarters can be quickly and easily shared throughout the organization, even across great geographical distances.[98] In the IBM study mentioned earlier, CEOs see technology as an enabler of openness, collaboration, and less rigid hierarchies.[99] Managers in varied business divisions or offices can now have the information they need to make important decisions quickly rather than waiting for decisions from headquarters. Social business technologies that enable people to meet, coordinate, and collaborate online facilitate communication and decision making among distributed, autonomous groups of workers, such as in virtual teams.
3. *Improved horizontal coordination and collaboration.* Perhaps one of the greatest outcomes of digital IT is its potential to improve coordination, communication, and collaboration across the firm. IT applications can connect people even when their offices, factories, or stores are scattered around the world, and many traditional tools companies use look outdated to young employees. A banking executive from Argentina participating in IBM's study said, "We are the e-mail generation; they are the social network generation." IBM makes extensive use of virtual teams, whose members use a wide variety of social business tools to easily communicate and collaborate. One team made up of members in the United States, Germany, and the United Kingdom used collaboration software as a virtual meeting room to solve a client's tough technical problem within the space of just a few days.[100] Siemens uses a global intranet that connects 450,000 employees around the world to share knowledge and collaborate on projects.[101] MITRE Corporation, an organization that provides consulting and research and development services, primarily to U.S. government clients such as the Department of Defense and the Federal Aviation Administration, uses social networking to overcome traditional barriers such as tenure, location, and functional affiliation that had previously limited information sharing and collaboration at the firm.[102]
4. *Enhanced network structures.* The high level of cross-organization collaboration needed in a virtual network organization structure, described in Chapter 3, would not be possible without the use of digital IT. In the business world, these are also sometimes called *modular structures* or *virtual organizations*. Outsourcing has become a major trend, thanks to digital technology that can tie companies together into a seamless information flow. For example, Hong Kong's Li & Fung is one of the biggest providers of clothing for retailers such as Abercrombie & Fitch, Guess, Ann Taylor, and Disney, but the company doesn't own any factories, machines, or fabrics. Li & Fung specializes in managing information, relying on an electronically connected web of 7,500 partners in 37 countries to provide raw materials and assemble the clothes. IT enables Li & Fung to stay in touch with worldwide partners and move items quickly from factories to retailers. It also lets retailers track orders as they move through production and make last-minute changes and additions.[103] With a virtual network structure, most activities are outsourced so that different companies perform the various functions needed by the organization. The speed and ease of digital communication makes the network structure a viable option for companies that want to keep costs low but expand activities or market presence.

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As an organization manager, keep this guideline in mind:

With greater use of IT, consider smaller organizational units, decentralized structures, improved internal coordination, and the possibility of outsourcing or a network structure.

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REMEMBER THIS

- Advances in IT are having a significant impact on organization design. Some specific implications of digital IT for organization design include smaller organizations, decentralized organization structures, and improved internal and external coordination.
- Digital technology has also enabled creation of the virtual network organization structure, in which a company subcontracts most of its major functions to separate companies.

KEY CONCEPTS

artificial intelligence
algorithm
algorithmic control
big data
big data analytics
codified knowledge
data intermediaries
data warehousing
digital media
exchange platforms
expert-locator system
intellectual capital
internal business intelligence
intranet
knowledge management
maker platforms
nudge management
platform-based organization
social network analysis
tacit knowledge
transaction processing systems

DISCUSSION QUESTIONS

1. How has the Internet of Things caused an explosion in the data available for analysis in organizations?
2. How do the underlying assumptions differ for a traditional "pipe" organization and a new platform-based digital organization?
3. In what ways might artificial intelligence incorporate bias into its decision making? Explain.
4. Is Amazon an exchange platform or maker platform organization? Explain.
5. How might a hospital administrator trying to implement cross-functional teams use social network analysis to improve communication and collaboration among nurses, doctors, technicians, and other staff?
6. Discuss some ways a large insurance company such as Allstate, Progressive, or State Farm might use social media tools such as microblogs or social networking. Do you think these tools are more applicable to a service company than to a manufacturing organization? Discuss.
7. Describe your use of codified knowledge when you research and write a term paper. Do you also use tacit knowledge regarding this activity? Discuss.
8. Why is knowledge management particularly important to a company that wants to learn and change continuously rather than operate at a stable state?
9. Caesars Entertainment centralized its big data analytics function to be more efficient. Can you think of some competitive issues that might lead a company to go from a centralized big data function to a function that decentralizes to various units?
10. Why do you think the application of digital technology typically leads to greater decentralization in an organization? Might it also be used for greater centralization in some organizations? Explain.

CHAPTER 9 WORKSHOP Manufacturing and Big Data: Organize the Project[104]

The era of big data has arrived. Discussions of terabytes and petabytes that were reserved for supercomputing facilities just a few years ago are common today. Companies are recognizing the tremendous value in the data they create, and they want to capitalize on that value. Manufacturing is leading the way as one of the largest producers of data from factory systems, machines, and sensors.

However, the rapid evolution of big data technologies, coupled with the hype surrounding these technologies, has led to "analytics paralytics" at some manufacturers. Questions of where to start and how to implement a big data technology can be answered in the following exercise.

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Step 1: By yourself, place the eight steps below in the sequential order you believe will be most effective for implementing big data analytics in a manufacturing plant. The first step would get a "1" and the last step would get an "8." Put your sequence number beside each item under "Your Sequence."

	Your Sequence	Team Sequence	Expert Sequence
Determine the required data sources			
Trust the new data			
Assign an operations manager as project leader			
Identify internal data/process experts			
Be ready to take curative action			
Target a specific challenge to address			
Define the required analytics			
Deploy and pray			

Step 2: Divide into small teams of three to four members and decide as a group the correct sequence of the eight steps above to implement big data in a manufacturing plant. Record your team sequence of steps in the second column above from "1" to "8."

Step 3: Your instructor will give you the expert's sequence to be placed in column 3 above. Your instructor will also read the rationale for each step in the project sequence.

Step 4: Compute the absolute difference (no minus numbers) between your individual score and the expert score. Add up the differences to derive your total score. Now do the same for the team score. Which score is lower? A low score is better. Did the collective knowledge of your team produce a lower score? Discuss the dynamic within your team that might explain your team score.

CASE FOR ANALYSIS | Hermitage Escalator Company[105]

Hermitage Escalator Company is an independent division of a large international manufacturer that sells and provides maintenance of elevators and escalators. Hermitage was started by an entrepreneur living in Hermitage, Tennessee in 1954, just as the demand for the "magic staircase" began to take off. In 1989 Hermitage was acquired by an elevator company that wanted to provide a full line of lift devices. Hermitage was able to maintain substantial autonomy as a separate division and to retain its brand name.

Hermitage sells over 2,000 escalators each year. Principal areas of escalator sales include department stores, shopping malls, airports, transit system stations, convention centers, hotels, arenas, stadiums, office buildings, and government buildings. At the extreme, an escalator may carry people up multiple stories or hundreds of feet horizontally along corridors such as in an airport concourse.

How Escalators Work

In its simplest form, an escalator is like a conveyor belt with a pair of long chains, one on each side, looped around gears at each end. An electric motor turns the drive gear at the top, which pulls and rotates the chain loops, similar to the chain mechanism on a bicycle. A typical escalator uses a 100-horsepower motor to rotate the gears. The motor and chain system are housed inside a metal structure extending between the two floors.

The chain loops move a series of steps. As the chains move, the steps stay level. At the top and bottom of the escalator, the steps collapse on each other, creating a flat platform. This makes it easier for riders to get on and off the escalator.

Each step in the escalator has two sets of wheels that roll along on two separate tracks. The set of wheels near the top of each step are connected to the rotating chains, and hence are pulled by the drive gear from the top of the escalator. The other set of wheels at the bottom of the step simply glide along its track. The tracks are placed so that each step always remains level. At the top and bottom of the escalator, tracks level off to a horizontal position, flattening the stairway. Each step has a series of grooves so it will fit together with the step behind it and in front of it during the flattening.

The electric motor in an escalator also moves the handrail. The handrail is simply a rubber conveyor belt

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that is looped around a series of wheels. This belt is precisely configured so that it moves at the same speed as the steps to give riders some stability.

An escalator is much better than an elevator for moving people a short distance because of the escalator's high loading rate. Escalator speeds vary from about 90 feet per minute to 180 feet per minute. An escalator moving 145 feet per minute can carry more than 10,000 people an hour, many more people than a standard elevator can move.

The Need for Maintenance

Although escalators are simple in concept, like all machinery there are many parts involved that may break down at any time. Safety mechanisms include inlet guards, an operating panel, safety switches, and step switches. The top and bottom operating units include a control panel, drive unit, main gear, drive chain, sprocket, and safety switches. The truss between floors includes the main track, trailing track, moving handrail drive unit, sprocket, moving handrail drive chain, and inlet guard. Other elements include the moving handrail, its interior panel, deck board, and skirt guard. The steps include the tread, riser, step demarcation line, driving rollers, and step chain.

Escalator maintenance is important for customer satisfaction because nobody likes to climb a broken escalator. Maintenance can also be a serious issue. There are horror stories of people falling into broken escalators that opened up when people were climbing up the stairs. Moreover, escalators have collapsed sending people tumbling to the bottom. Escalators have caught fire, such as in 1987 when an escalator in a London Underground station actually exploded, sending flames into the ticketing office, killing 31 people. The cause was the accumulation of pounds of tiny bits of paper and lint that had collected in the inner workings and undercarriage of the machine.

The IoT

Approximately 28,000 new escalators and elevators are installed each year in the United States. Hermitage, like all manufacturing companies, was facing an industrial revolution, popularly known as Industry 4.0 or the industrial Internet of Things, as manufacturing converged with the digital economy, specifically with emerging big data collection systems and analytics. There is much discussion of how to create profitable business models using big data analytics. The best approach may be to identify bottlenecks and other problems, determine what real-time data is needed to overcome the problem, and then apply appropriate sensors, wireless connections, and analytics to collect, transfer and analyze this data. Hermitage must also decide what action should be taken in response to a problem, such as how to provide data or a data visualization to decision-makers, or even how to create decision algorithms that would automatically decide what action should be taken in response to a problem.

Concerns at Hermitage

Mardell Anderson, maintenance superintendent at Hermitage, had a number of concerns about digitalizing the new escalators as part of the industrial Internet of Things. According to Anderson, "Fixing an escalator the first time, every time, is crucial to maintain customers and reduce labor costs. I would really like to see our ability to fix a problem before it happens. Prediction and prevention, as opposed to reaction, is where the industry is headed. We are driving toward preventative and predictive maintenance out of necessity. If we can install sensors and Internet of Things components, we could dispatch the right people to fix the right problem at the right time. Or better yet, prevent the problem from occurring at all."

Low-rise escalator equipment can be maintained with competent technical know-how. Competent maintenance workers make about $50 per hour and can earn over $100,000 a year with overtime. An IoT package is cost-effective on new escalators but expensive to retrofit on legacy escalators. "It will take several years to replace legacy escalators," Anderson said. "In the meantime, we are learning the weak spots in our escalator systems and where sensors would have the best payoff. It would be great if we had information coming from the equipment to tell us which mechanics to send and when to send them but that is several years away on our installed maintenance base. It could be 10 years before we have all of our installed escalators talking and communicating in a meaningful way."

Anderson wanted to be creative in his approach to maintenance during the 10-year interim. "Is it possible to find another way to achieve predictive maintenance? We have a lot of repair and callback history that we could use to do a big data-type effort, even before escalators have sensors and are connected to the IoT. Knowing that a large percentage of our callbacks are related to electric motors and chains, for example, is important. I want us to get better at using the data we already have as we move toward big data analytics."

"A really good mechanic can troubleshoot an escalator over the phone by just asking questions," Anderson says. "There are not millions of things that can go wrong. There is a finite number of questions for every escalator that would lead them down the right path. That kind of knowledge needs to be part of our predictive maintenance system."

Anderson continued, "Our challenge is selecting and positioning the sensors and cameras within the units and

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then selecting the right things to measure in order to arrive at predictive capability. Measuring the right things using well-placed hardware and connecting it to the cloud would not achieve our goal without clear rules. The rules of maintenance are not derived from a rulebook, but from the accumulated knowledge and expertise of hundreds of maintenance and repair mechanics over decades of service. As part of the remote monitoring program, our rules for data collection and remote monitoring will allow the first generation of rules to be written that help dispatch the right person to the right problem."

"Now we are taking this knowledge to the next level to do predictive analytics. We want to capture and transfer knowledge that we have in our most talented technicians down to the next generation that will lead us into our future service model. With seemingly unlimited IoT data on the horizon from sensor technology, we will use this information to rewrite the rules on how we dispatch and who we send on service for maintenance calls."

"Predictive maintenance analytics will not be easy to put into practice. For example, with new data coming in, we can expect to see 'false positives' – meaning indicators that something was wrong when nothing was wrong. With matters of safety and satisfaction, how could a technician know if the alarm was a false one? False positives have the potential to increase our costs, not decrease them. Then there is the issue of natural variability in our operating equipment. How can we set parameters on distinguishing what we call "noise" from a problem that requires action? In addition, once it is determined that an action has to be taken, what should that action be? Could a certain maintenance action be bundled together with other maintenance items and then addressed as part of the next regularly scheduled maintenance service?"

"When you move to a predictive model, you can easily drive up costs. If you take every single thing that was sensed and automatically send a technician to check it out, you spend money for each visit with no benefit. That would cost a lot. If there is a safety issue or an error that could cause a shutdown, then dispatch the technician right away. But, if we are being smart, some issues detected can be bundled into our next maintenance visit to the location."

"So, my thinking is that when we write our rules for maintenance and maintenance calls, we should start with analyzing the callbacks and repairs in our history, because that is where we can influence costs and outcomes. The existing data could help us tremendously. We for sure know on which type of equipment each callback or repair occurred."

At Hermitage, all new installations will have an IoT sensor package installed. A big question is how the Internet of Things can be used to increase revenue and decrease rather than increase costs, all the while providing better customer service. How can Hermitage capture all the promise of IoT to deliver more value to the customer and to itself?

Questions

1. How might Hermitage codify and manage the knowledge of experienced maintenance technicians into the new rules to be written for handling maintenance responses under the upcoming deluge of big data from the Internet of Things? Explain.
2. How might big data analytics actually be more costly rather than less costly with respect to maintaining escalators?
3. What specific value might come from analyzing data on past maintenance calls? What specific data do you think would have value? Why?

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CHAPTER

10 Organization Size, Life Cycle, and Decline

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Learning Objectives

After reading this chapter you should be able to:

1. Explain the advantages and disadvantages of large organization size.
2. Describe how an organization progresses through four stages of the organizational life cycle.
3. Define the characteristics of bureaucracy.
4. Compare large organizations and small organizations along the dimensions of formalization, centralization, and personnel ratios.
5. Identify approaches to reducing bureaucracy in large organizations.
6. Contrast market and clan control with bureaucratic control.
7. Describe the model of decline stages.

Chapter Outline

Organization Size: Is Bigger Better?
Pressures for Growth • Dilemmas of Large Size

Organizational Life Cycle
Stages of Life-Cycle Development • Organizational Characteristics During the Life Cycle

Organizational Size, Bureaucracy, and Control
What Is Bureaucracy? • Size and Structural Control

Bureaucracy in a Changing World
Organizing Temporary Systems • Other Approaches to Busting Bureaucracy

Bureaucracy and Other Forms of Control
Bureaucratic Control • Market Control • Clan Control

Organizational Decline
Definition and Causes • A Model of Decline Stages

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **It is wise for the entrepreneur who starts a new company to maintain hands-on management control as the company grows.**

I AGREE _____ I DISAGREE _____

2 **A manager should emphasize shared values, trust, and commitment to the organization's mission as the primary means of controlling employee behavior.**

I AGREE _____ I DISAGREE _____

3 **If an organization starts into a state of decline, recovery is very unlikely.**

I AGREE _____ I DISAGREE _____

"Southwest is in a better position today than it has ever been in its history," said the airline's Chairman and CEO Gary Kelly. But even Kelly knows that Southwest is beginning to show signs of growing old. He admits that not only the airline industry, but Southwest's position in that industry, has changed. Its growth has stalled. The low fares that were long the core selling point with customers aren't so low anymore. Other U.S. airlines have been offering programs and services that captured business travelers. Ultra-discounters have undercut Southwest's fares. Southwest has not only battled difficult weather conditions that caused the cancellation of thousands of flights but has also been struggling through maintenance disruptions arising from a dispute with its mechanics union. Moreover, Southwest's fleet includes more of the Boeing 737 Max planes than any other carrier. The 737 Max was grounded in March 2019 after two fatal crashes. In the first quarter of 2019, the combination of the 737 Max grounding, weather disruptions, and the mechanics union dispute led to the cancellation of more than 9,000 Southwest flights. Many employees long for the days of co-founder and former CEO and executive chairman Herb Kelleher, who was known for his outlandish costumes, love of Wild Turkey bourbon, and riding Harley-Davidson motorcycles. "Ever since Herb . . . left, this has been more of a corporation and less of a family," said union representative Randy Barnes.[1]

As organizations like Southwest grow large and complex, they need more complex systems and procedures for guiding and controlling the organization. Moreover, the addition of more complex systems and procedures can cause problems of inefficiency, rigidity, and slow response time, meaning that the company has a hard time innovating or adapting quickly to changes in the environment or to customer needs.

Southwest Airlines has enjoyed a long period of "youth," staying in the innovative, adaptable startup mindset longer than most organizations, but every organization—from locally owned restaurants and auto body shops to large international firms, nonprofit organizations, and law-enforcement agencies—eventually wrestles with questions about organizational size, bureaucracy, and control. During the twentieth century, large organizations became widespread, and bureaucracy has become a major topic of study in organization theory and design.[2] Most large organizations have bureaucratic characteristics, which can be very effective. These organizations provide us with abundant goods and services and

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accomplish astonishing feats—explorations of Mars, overnight delivery of packages to any location in the world, the scheduling and coordination of thousands of airline flights a day—that are testimony to their effectiveness. On the other hand, bureaucracy is also accused of many sins, including inefficiency, rigidity, and demeaning routinized work that alienates both employees and the customers an organization tries to serve.

Purpose of This Chapter

In this chapter, we explore the question of large versus small organizations and how size relates to structure and control. Organization size is a major contingency that influences organization design and functioning, just as do the contingencies—technology, environment, goals—discussed in previous chapters. In the first section, we look at the advantages of large versus small size. Then, we explore what is called an organization's life cycle and the structural characteristics at each stage. Next, we examine the historical need for bureaucracy as a means to control large organizations and compare bureaucratic control to various other control strategies. Finally, the chapter looks at the causes and stages of organizational decline. By the end of this chapter, you should be able to recognize when bureaucratic control can make an organization effective and when other types of control are more appropriate.

10.1 Organization Size: Is Bigger Better?

The question of big versus small begins with the notion of growth and the reasons so many organizations feel the need to grow large.

10.1a Pressures for Growth

Do you ever dream of starting a small company? Many people do, and entrepreneurial startups are the lifeblood of the U.S. economy. Yet the hope of practically every entrepreneur is to have his or her company grow fast and grow large, maybe even to eventually make the *Fortune* 500 list.[3] Think of Amazon, which started in 1994 as a small company with around 150 employees selling books over the Internet. In 2018, Amazon ranked 8th on the list of America's largest corporations. It has more than 647,500 employees, offers more than 3 billion products on marketplaces around the world, is a global leader in cloud computing, and is building its own air cargo fleet. Selling items online is just a small piece of Amazon's total business. The company's sales and revenue keep growing.[4]

Industry consolidation, global expansion, and diversification have made firms considerably larger over the past few decades. Despite the proliferation of new, small organizations, giants such as Apple, Toyota, JPMorgan Chase, and Walmart have continued to grow. In 2018, Apple reached a market value of more than $1 trillion, reflecting the fact that a number of extremely large companies have come to dominate the U.S. economy. Consider that in 1975, 109 companies collected half of the profits produced by all publicly traded companies in the United States. In 2018, that percentage of the profits was collected by just 30 companies.[5]

Organizations in all industries, from retail, to aerospace, to media, strive for growth to acquire the size and resources needed to compete on a global scale, to

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invest in new technology, and to control distribution channels and guarantee access to markets.[6] There are a number of other pressures for organizations to grow. Many executives have found that firms must grow to stay economically healthy. To stop growing is to stagnate. To be stable means that customers may not have their demands fully met or that competitors will increase market share at the expense of your company. At Walmart, managers have vowed to continue an emphasis on growth even if it means a decreasing return on investment (ROI). They are ingrained with the idea that to stop growing is to stagnate and die. Walmart's former chief financial officer Tom Schoewe once said that even if the ROI could "come down a bit and we could grow faster, that would be just fine by me."[7]

Large size enables companies to take risks that could ruin smaller firms, and scale is crucial to economic health in some industries. There is currently a wave of mergers in the U.S. healthcare industry, for example, as hospitals, medical groups, and insurers strive to control healthcare costs and meet new challenges. One illustration is the merger of CVS Health, one of the largest pharmacy chains in the United States, with Aetna, one of the country's largest health insurers.[8] Declining freight rates have pushed consolidation in the shipping industry. Danish giant Møeller-Maersk recently split its transport and logistics businesses and its oil-related businesses into two independent divisions so that each will have greater flexibility to continue growing through acquisitions. Maersk group CEO Søren Skou said the company wanted to make sure it has "the fire power to do big things if opportunities come up."[9] For marketing-intensive companies such as Coca-Cola and Procter & Gamble, greater size provides power in the marketplace and thus increased revenues.[10] Through a series of mergers and acquisitions, the Belgian brewing company Interbrew (now Anheuser-Busch InBev) became the world's largest brewer and distributor of beer, giving the company tremendous power in the industry. In addition, growing organizations are vibrant, exciting places to work, enabling these companies to attract and keep quality employees. When the number of employees is expanding, the company can offer many challenges and opportunities for advancement.

10.1b Dilemmas of Large Size

Organizations feel compelled to grow, but how much and how large? What size organization is better poised to compete in a fast-changing global environment? The arguments are summarized in Exhibit 10.1.

Large. Huge resources and economies of scale and scope are needed for many organizations to compete globally. Only large organizations can build the massive Keystone Pipeline, an oil pipeline system running from Western Canada down through the United States. Only a large corporation like General Electric can afford to build ultra-efficient $2 million wind turbines that contain 8,000 different parts.[11] Only a large Johnson & Johnson can invest hundreds of millions of dollars in new products such as bifocal contact lenses and a patch that delivers contraceptives through the skin. A study that looked at 99 developing countries found that large firms had significantly higher productivity than small firms. The connection between size and productivity is also especially strong in the United States because of economies of scale and scope.[12] The U.S. shale boom was pioneered by small, nimble companies like EOG Resources and Continental Resources, but economies of scale and scope later gave an advantage to giant firms such as Chevron and Exxon Mobil. Scale enables

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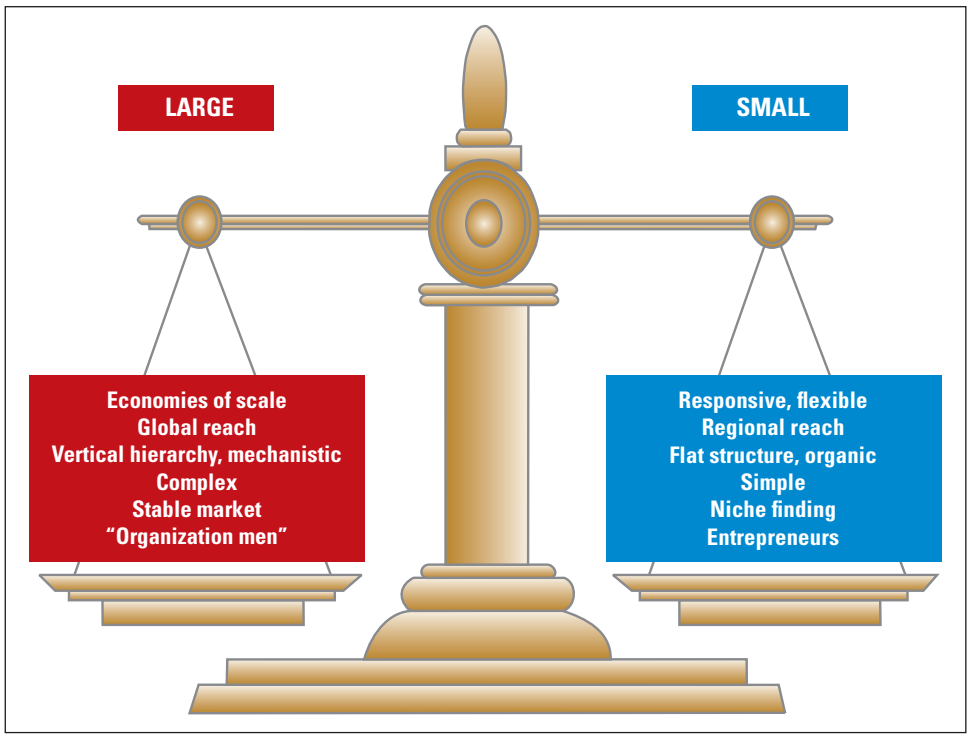
EXHIBIT 10.1
Differences Between Large and Small Organizations



Source: Based on John A. Byrne, "Is Your Company Too Big?" *Businessweek*, March 27, 1989, 84–94.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Decide whether your organization should act like a large or small company. To the extent that economies of scale, global reach, and complexity are important, introduce greater bureaucratization as the organization increases in size. As it becomes necessary, add rules and regulations, written documentation, job specialization, technical competence in hiring and promotion, and decentralization.

the larger firms to drive down costs, secure pipeline access more quickly, and lock in better labor deals and other contracts, says Uday Turanga, CEO of ADI Analytics. Jeff Shellebarger, Chevron's president of North America exploration and production, agrees. "You need scale once you're in development mode to be able to succeed at the margins that you have," Shellebarger says. Chevron's production in the Permian Basin soared to more than 300,000 barrels of oil and gas a day during the third quarter of 2018, an increase of 80 percent from the previous year. By comparison, it took a smaller company four years to boost production from 10,000 to 100,000 barrels.[13]

Large firms are also better able to weather economic downturns that can put smaller companies out of business, and they can provide greater social support to the communities they serve.[14] After the 2011 earthquake, tsunami, and nuclear disaster in Japan, the insurance company Aflac, which derives most of its revenue from that country, gave customers a six-month grace period to pay their insurance premiums. In addition, Aflac donated millions of dollars to relief efforts.[15] Large organizations also are able to get back to business more quickly following a disaster, giving employees and communities a sense of security during an uncertain time.

Large companies are standardized, often mechanistically run, and complex. The complexity offers hundreds of functional specialties within the organization to perform multifaceted tasks and to produce varied and complicated products. Moreover, large organizations, once established, can be a presence that stabilizes a market for years. Managers can join the company and expect a career reminiscent of the "organization men" of the 1950s and 1960s. The organization can provide longevity, raises, and promotions.

Small. The competing argument says small is beautiful because the crucial requirements for success in a global economy are responsiveness and flexibility in fast-changing markets. Small scale can provide significant advantages in terms of

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quick reaction to changing customer needs or shifting environmental and market conditions.[16] In addition, small organizations often enjoy greater employee commitment because it is easier for people to feel like part of a community. Employees typically work on a variety of tasks rather than narrow, specialized jobs. For many people, working in a small company is more exciting and fulfilling than working in a huge organization. Where would you be happier as a manager? Complete the questionnaire in this chapter's "How Do You Fit the Design?" box for some insight.

Many large companies have grown even larger through merger or acquisition in recent years, yet research indicates that few mergers live up to their expected performance levels. Studies by consulting firms such as McKinsey & Company, Hay Group, and others suggest that performance declines in almost 20 percent of acquired companies after acquisition. By some estimates, 90 percent of mergers and acquisitions never live up to expectations. Many researchers and analysts agree that, frequently, bigness just doesn't add up to better performance.[17] Consider Pulte Group, one of the nation's largest home-builders, which acquired Centex

HOW DO YOU FIT THE DESIGN?

WHAT SIZE ORGANIZATION FOR YOU?

How do your work preferences fit organization size? Answer the following questions as they reflect your likes and dislikes. Please answer whether each item is Mostly True or Mostly False for you.

		Mostly True	Mostly False
1.	I value stability and predictability in the organization I work for.	_____	_____
2.	Rules are meant to be broken.	_____	_____
3.	Years of service should be an important determinant of pay and promotion.	_____	_____
4.	I generally prefer to work on lots of different things rather than specialize in a few things.	_____	_____
5.	Before accepting a job, I would want to make sure the company had good benefits.	_____	_____
6.	I would rather work on a team where managerial responsibility is shared than work in a department with a single manager.	_____	_____
7.	I would like to work for a large, well-known company.	_____	_____
8.	I would rather earn $90,000 a year as a VP in a small company than earn $100,000 a year as a middle manager in a big company.	_____	_____

Scoring: Give yourself one point for each odd-numbered item you marked Mostly True and one point for each even-numbered item you marked Mostly False.

Interpretation: Working in a large organization is a very different experience from working in a small organization. The large organization is well-established, provides good benefits, is stable, and has rules, well-defined jobs, and a clear management hierarchy of authority. A small organization may be struggling to survive, but it offers excitement, multitasking, risk, and the sharing of responsibility. If you scored 6 or more, a large organization may be for you. If you scored 3 or less, you may be happier in a smaller, less-structured organization.

Source: From Don Hellriegel, Susan E. Jackson, and John W. Slocum. *Managing: A Competency-Based Approach*, 11th ed. (Mason, OH: South-Western, a part of Cengage Learning, Inc., 2008). Reproduced by permission. http://www.cengage.com/permissions.

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Corporation in 2009. The challenges of integrating the two companies, combined with a weakening housing market, wreaked havoc on Pulte's profitability. Between the time of the acquisition and mid-2011, Pulte had just one profitable quarter and had lost millions of dollars.[18]

Despite the increasing size of many companies, the economic vitality of the United States as well as most of the rest of the developed world is tied to small and mid-sized businesses. According to the Small Business Administration, small businesses represent more than 99 percent of all businesses in the United States. The 30.2 million small firms in the United States employ almost 59 million people. In addition, small firms created 1.9 million net new jobs in 2015, the most recent year for which data are available.[19] A large percentage of exporters are small businesses. The growth of the Internet and digital technology has made it easier for small companies to compete with larger firms. The growing service sector also contributes to a decrease in average organization size, as many service companies remain small to better serve customers.

Small organizations have a flat structure and an organic, free-flowing management style that encourages entrepreneurship and innovation. Today's leading biotechnology drugs, for example, were all discovered by small firms such as Gilead Sciences, which developed anti-retroviral drugs to treat HIV, rather than by huge pharmaceutical companies such as Pfizer.[20] Moreover, the personal involvement of employees in small firms encourages motivation and commitment because employees personally identify with each other and with the company's mission. Anthropologist Robin Dunbar studied primitive societies, religious sects, military organizations, and some businesses and proposed that 150 is the optimum size for any group trying to achieve a goal. Dunbar says that beyond that size, the group's effectiveness wanes because too many rules, procedures, and red tape slow things down and sap group morale, enthusiasm, and commitment.[21]

BRIEFCASE

As an organization manager, keep this guideline in mind:

If responsiveness, flexibility, simplicity, and niche finding are important, subdivide the organization into simple, autonomous divisions that have freedom and a small-company approach.

Big-Company/Small-Company Combination. The paradox is that the advantages of small companies sometimes enable them to succeed and, hence, grow large. Small companies can become victims of their own success as they grow, shifting to a mechanistic design emphasizing vertical hierarchy and spawning "organization men" rather than entrepreneurs. Giant companies are "built for optimization, not innovation."[22] Big companies become committed to their existing products and technologies and have a hard time supporting innovation for the future.

The solution is what Jack Welch, retired chairman and CEO of General Electric, called the "big-company/small-company hybrid" that combines a large corporation's resources and reach with a small company's simplicity and flexibility. These companies incorporate structures and processes that enable them to be both adaptable and efficient at the same time. That is, they use an *ambidextrous approach*, incorporating structures and processes that are appropriate for both small-company creativeness and large-company systems for exploiting innovations. For example, a loose, flexible structure and greater employee freedom are excellent for the creation and initiation of ideas; however, these same conditions often make it difficult to implement a change because employees are less likely to comply. With an ambidextrous approach, managers encourage flexibility and freedom to innovate and propose new ideas within some departments, but they use a more rigid, centralized, and standardized approach for implementing innovations across the organization.[23] For example, when Mike Lawrie was CEO of the London-based software company Misys (now part of Finastra), he created a separate unit for Misys Open Source Solutions, a venture aimed at creating a potentially disruptive technology in the healthcare industry. Lawrie wanted creative people to have the time and resources they needed to work on new

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software to provide seamless data exchange among hospitals, physicians, insurers, and others involved in the healthcare system. Implementation of new ideas, where routine and precision are important, occurred within the regular organization.[24] The divisional structure, described in Chapter 3, is another way some large organizations attain a big-company/small-company hybrid. By reorganizing into groups of small companies, huge corporations such as Johnson & Johnson capture the mindset and advantages of smallness. Johnson & Johnson is actually a group of 250 separate companies operating in 57 countries.[25] Michael Dell is trying to bring the shine back to his organization by giving divisions the autonomy to act like startups.

IN PRACTICE

Dell Inc.

Dell was once the top PC maker in the world, but the PC business has been declining for some years. As Dell transitions from a PC company to a "solutions company," founder and CEO Michael Dell is trying to return his company to its entrepreneurial roots.

Dell is moving into new areas such as cybersecurity and data center design and management, and letting those new units operate more autonomously. Forrest Norrod, who runs the unit designing data centers, says he has permission to ignore some of the corporate office's "help." Michael Dell says he wants the units to act more creatively and less bureaucratically so he is taking a hands-off approach. Norrod's division is housed at Dell's Parmer South campus, eight miles from headquarters. When employees couldn't find rulers to measure server racks, they used dollar bills. One employee built a special chassis in his garage. Duct tape has been used to attach a power supply. It might not seem like the way to run a computing giant, but Norrod and Michael Dell agree that it is the way to run a fast, flexible, entrepreneurial startup. That might be the best chance Dell has to get ahead of its larger tech rivals.[26]

Other companies are also finding ways to be both big and small. Retail giant Lowe's, for example, uses the advantage of size in areas such as advertising, purchasing, and raising capital, but it also gives each individual store manager the autonomy needed to serve customers as if it were a small, hometown shop. To avoid the problem of isolated top managers, mutual fund manager Vanguard requires everyone—even the CEO—to spend some time each month manning the phones and talking directly to customers.[27] Small companies that are growing can use these ideas to help their organizations retain the flexibility and customer focus that fueled their growth.

REMEMBER THIS

- Organizations experience many pressures to grow, and large size is crucial to economic health in some industries.
- Size enables economies of scale, provides a wide variety of opportunities for employees, and allows companies to invest in expensive and risky projects. However, large organizations have a hard time adapting to rapid changes in the environment.
- Large organizations are typically standardized, mechanistically run, and complex.
- Small organizations typically have a flatter structure and an organic, free-flowing management.
- Small organizations can respond more quickly to environmental changes and are more suited to encouraging innovation and entrepreneurship.
- Managers in large or growing firms try to find mechanisms to make their organizations more flexible and responsive.

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BRIEFCASE

As an organization manager, keep these guidelines in mind:

Grow when possible. With growth, you can provide opportunities for employee advancement and greater profitability and effectiveness. Apply new management systems and structural configurations at each stage of an organization's development. Interpret the needs of the growing organization and respond with the management and internal systems that will carry the organization through to the next stage of development.

10.2 Organizational Life Cycle

A useful way to think about organizational growth and change is the concept of an organizational **life cycle**, which suggests that organizations are born, grow older, and eventually die.[28] Organization structure, leadership style, and administrative systems follow a fairly predictable pattern through stages in the life cycle. Stages are sequential and follow a natural progression.

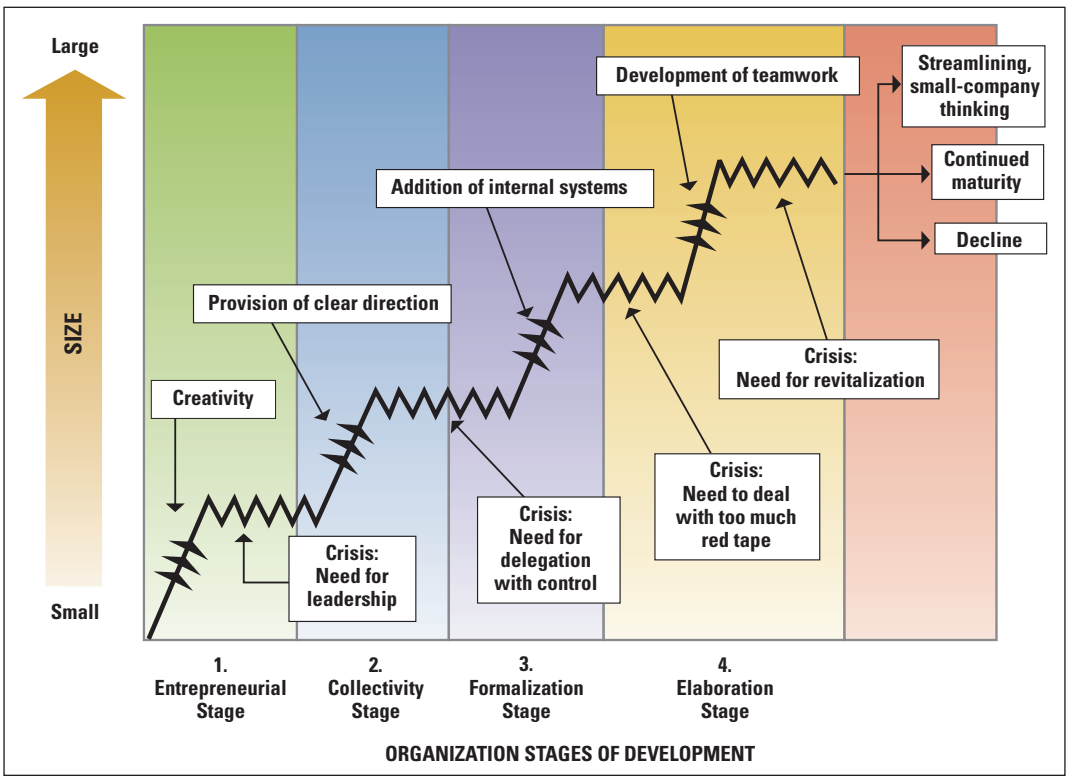
10.2a Stages of Life-Cycle Development

Research on organizational life cycle suggests that four major stages characterize organizational development.[29] Exhibit 10.2 illustrates these four stages and the problems associated with transition to each stage.

Definitions. Growth is not easy. Each time an organization enters a new stage in the life cycle, it enters a whole new ball game with a new set of rules for how the organization functions internally and how it relates to the external environment.[30]

1. *Entrepreneurial stage.* When an organization is born, the emphasis is on creating a product or service and surviving in the marketplace. The founders are entrepreneurs, and they devote their full energies to the technical activities of production and marketing. The organization is informal and non-bureaucratic. The

EXHIBIT 10.2
Organizational Life Cycle



Source: Adapted from Robert E. Quinn and Kim Cameron, "Organizational Life Cycles and Shifting Criteria of Effectiveness: Some Preliminary Evidence," *Management Science* 29 (1983), 33–51; and Larry E. Greiner, "Evolution and Revolution as Organizations Grow," *Harvard Business Review* 50 (July–August 1972), 37–46.

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hours of work are long. Control is based on the owners' personal supervision. Growth is from a creative new product or service. For example, Dennis Crowley and Naveen Selvadurai created the first version of Foursquare—a mobile networking service that lets users share their locations with friends, bookmark information about venues they want to visit, and share tips and experiences—at Crowley's kitchen table in New York City's East Village. They launched the service in 2009 in Austin, Texas, and within a few years it had more than 45 million active users. Crowley served as CEO during the company's early years.[31] The founding of Foursquare is reminiscent of Apple (originally Apple Computer), which was in the **entrepreneurial stage** when it was created by Steve Jobs and Stephen Wozniak in Wozniak's parents' garage in 1976.

Crisis: Need for leadership. As the organization starts to grow, the larger number of employees causes problems. The creative and technically-oriented owners are confronted with management issues, but they may prefer to focus their energies on making and selling the product or inventing new products and services. At this time of crisis, entrepreneurs must either adjust the structure of the organization to accommodate continued growth or else bring in strong managers who can do so. For example, although he still plays an active role at Foursquare, Dennis Crowley stepped down as CEO in 2016, after spending a couple of years building a solid management team. "I was self-aware enough to know that I'm good at a lot of things, like building products," Crowley said, "but [management] was not one of them."[32] The daily deals e-commerce marketplace Groupon, founded in 1998 by Andrew Mason and a couple of friends, experienced phenomenal growth, but Mason didn't seem interested in managing a large company and was forced out in early 2013. "I view Mason as a visionary idea generator," said one analyst. "Few would argue with how impressive the Groupon organization was as it grew. However, at some point, it became the overgrown toddler of the Internet . . . not quite ready to make adult decisions."[33]

2. *Collectivity stage.* If the leadership crisis is resolved, strong leadership is obtained and the organization begins to develop clear goals and direction. Departments are established along with a hierarchy of authority, job assignments, and a beginning division of labor. In the **collectivity stage**, employees identify with the mission of the organization and spend long hours helping the organization succeed. Members feel part of a collective. Communication and control are mostly informal, although a few formal systems begin to appear. Apple was in the collectivity stage during its rapid growth years from 1978 to 1981. Jobs remained as CEO and visionary leader, although A. C. Markkula had been brought in as CEO to handle most of the management responsibilities. Employees threw themselves into the business as the major product line was established and more than 2,000 dealers signed on.

Crisis: Need for delegation. If the new management has been successful, lower-level employees gradually find themselves restricted by the strong top-down leadership. Lower-level managers begin to acquire confidence in their own functional areas and want more discretion. An autonomy crisis occurs when top managers, who were successful because of their strong leadership and vision, do not want to give up responsibility. Top managers want to make sure that all parts of the organization are coordinated and pulling together. The organization needs to find mechanisms to control and coordinate departments without direct supervision from the top. For example, when Diamond Wipes International reached a point where costly mistakes were being made because of poor communication among departments, Taiwanese entrepreneur Eve Yen hired a general manager and charged him with coordinating the work of all departments.[34]

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ASSESS YOUR ANSWER

1 It is wise for the entrepreneur who starts a new company to maintain hands-on management control as the company grows.

ANSWER: *Disagree.* Entrepreneurs typically enjoy using their creativity to make and sell a new product or service. Many stay hands-on too long because they have a hard time shifting to the role of managing other people and setting up procedures and systems the company needs as it grows. In most cases, successful entrepreneurs bring in skilled managers to run the business and take the organization to the next level.

3. *Formalization stage.* The **formalization stage** involves the installation and use of rules, procedures, and control systems. In the formalization stage, communication is less frequent and more formal, and more likely to follow the hierarchy of authority. Engineers, human resource specialists, and other staff may be added. Top management becomes concerned with issues such as strategy and planning and leaves the operations of the firm to middle management. Product groups or other decentralized units may be formed to improve coordination. Incentive systems based on profits may be implemented to ensure that managers work toward what is best for the overall company. Uber is currently in the early formalization stage. As described in previous chapters, co-founder Travis Kalanick was forced out after months of scandal and negative media attention. Board members conducted an investigation of Uber's culture following allegations of sexism and sexual harassment and are now working with new CEO Dara Khosrowshahi to develop formal rules and procedures to guide the company and ensure oversight.[35] When effective, the new coordination and control systems enable the organization to continue growing by establishing linkage mechanisms between top management and field units. Internet companies such as eBay and Amazon.com are in the late formalization stage of the life cycle, with managers devising new systems to manage the growing complexity of operations.

Crisis: Too much red tape. At this point in the organization's development, the proliferation of systems and programs may begin to strangle middle-level executives. The organization seems bureaucratized. Middle management may resent the intrusion of staff. Innovation may be restricted. The organization seems too large and complex to be managed through formal programs.

4. *Elaboration stage.* The solution to the red tape crisis is a new sense of collaboration and teamwork. Throughout the organization, managers develop skills for confronting problems and working together. Bureaucracy may have reached its limit. Social control and self-discipline reduce the need for additional formal controls. Managers learn to work within the bureaucracy without adding to it. Formal systems may be simplified and replaced by manager teams and task forces. To achieve collaboration, teams are often formed across functions or divisions of the company. The organization may also be split into multiple divisions to maintain a small-company philosophy. Apple is currently in the **elaboration stage** of the life cycle, as are such large companies as Toyota, General Electric, described in the Chapter 1 opening example, Caterpillar, and Southwest Airlines, described at the beginning of this chapter.

Crisis: Need for revitalization. After the organization reaches maturity, it may enter periods of temporary decline.[36] A need for renewal may occur every 10 to 20 years. The organization shifts out of alignment with the environment or perhaps becomes slow moving and over-bureaucratized, so it must go through a stage of

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streamlining and innovation. Top managers are often replaced during this period. At Apple, the top spot changed hands a number of times as the company struggled to revitalize over the years between 1985 and 1997. Steve Jobs returned in mid-1997 to run the company he had founded nearly 25 years earlier. Jobs quickly reorganized the company, weeded out inefficiencies, and refocused Apple on innovative products for the consumer market. Jobs moved the company in a whole new direction with the iPod music system and the iPhone. Sales and profits zoomed and Apple entered a long period of success.[37] Tim Cook, who took over as CEO in 2011 following Jobs's resignation and subsequent death, was hired by Jobs in 1998, soon after he returned as CEO, and Cook handled most day-to-day operations while Jobs provided visionary leadership.[38] Apple is still highly successful, but it will continue to face the problems all mature organizations deal with. All mature organizations must go through periods of revitalization or they will decline, as shown in the last stage of Exhibit 10.2.

Summary. Eighty-four percent of businesses that make it past the first year still fail within five years because they can't make the transition from the entrepreneurial stage.[39] The transitions become even more difficult as organizations progress through future stages of the life cycle. Organizations that do not successfully resolve the problems associated with these transitions are restricted in their growth and may even fail. For technology companies and platform-based organizations, life cycles are getting shorter. To stay competitive, companies like Facebook, Netflix, and Google progress through stages of the life cycle faster than traditional industrial organizations. From within an organization, the life-cycle crises are very real. Consider how Airbnb is confronting a life cycle crisis in the formalization stage of development.

IN PRACTICE
Airbnb

When Brian Chesky and Joe Gebbia couldn't afford the rent on their San Francisco apartment, they decided to turn their loft into short-term rental space for a local design conference. That decision eventually transformed into Airbnb (originally AirBedandBreakfast.com), which was founded by Chesky, Gebbia, and a former roommate, Nathan Blecharczyk, in 2008. Airbnb quickly became a household name and its value skyrocketed to $30 billion within less than a decade. Two million "hosts" around the world signed up to rent out their spare rooms or empty homes. Many of those hosts and their guests liked the "crash on my couch" informality, with guests sharing the family bathroom filled with half-empty shampoo bottles and watching television and eating meals with the host family.

Now, however, Airbnb is experiencing growing pains. As this new form of hospitality expanded, more people began expecting the same kind of service they get in a traditional hotel. To provide guests with a reliable experience, Airbnb began encouraging hosts to use new technology tools on the website that let travelers book instantly, to adopt the company's policies for cancellations and check-in times, and to behave more like the front desk staff at a hotel. Chesky, who serves as CEO, created a position of global head of hospitality and strategy and hired the founder of Joie de Vivre Hotels to create standards around cleanliness, communication, safety concerns, and other hospitality issues. Hosts can earn badges for having "business-friendly" listings that include standard hotel amenities like a hair dryer and Wi-Fi.

Mark Scheel, a software engineer who rents out his ski condo, likes the changes Airbnb has been making. "The changes that have added more rigidity have also led to a better guest experience, which makes them happier and brings in more business for me," Scheel said. Others, like Jill Bishop, who began renting out her spare room in 2008, aren't as pleased with Airbnb's desire for that room to be more like a Hilton or a Hyatt. "Now I'm less in touch with how life-enriching [Airbnb] was and more in touch with the hassle," she said. Chesky and other managers will likely continue to add rules, procedures, and control systems that can help the company continue to grow.[40]

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10.2b Organizational Characteristics During the Life Cycle

As organizations evolve through the four stages of the life cycle, changes take place in structure, control systems, innovation, and goals. The organizational characteristics associated with each stage are summarized in Exhibit 10.3.

Entrepreneurial. Initially, the organization is small, non-bureaucratic, and a one-person show. The top manager provides the structure and control system. Organizational energy is devoted to survival and the production of a single product or service.

Collectivity. This is the organization's youth. Growth is rapid, and employees are excited and committed to the organization's mission. The structure is still mostly informal, although some procedures are emerging. Strong charismatic leaders provide direction and goals for the organization. Continued growth is a major goal.

Formalization. At this point, the organization is entering midlife. Bureaucratic characteristics emerge. The organization adds staff support groups, formalizes procedures, and establishes a clear hierarchy and division of labor. At the formalization stage, organizations may also develop complementary products to offer a complete product line. Innovation may be achieved by establishing a separate research and development (R&D) department. Major goals are internal stability and market expansion. Top management delegates, but it also implements formal control systems.

EXHIBIT 10.3
Organization Characteristics During Four Stages of Life Cycle

	1. Entrepreneurial	2. Collectivity	3. Formalization	4. Elaboration
Characteristic	**Nonbureaucratic**	**Pre-bureaucratic**	**Bureaucratic**	**Very Bureaucratic**
Structure	Informal, one-person show	Mostly informal, some procedures	Formal procedures, division of labor, new specialties added	Teamwork within bureaucracy, small-company thinking
Products or services	Single product or service	Major product or service, with variations	Line of products or services	Multiple product or service lines
Reward and control systems	Personal, paternalistic	Personal, contribution to success	Impersonal, formalized systems	Extensive, tailored to product and department
Innovation	By owner-manager	By employees and managers	By separate innovation group	By institutionalized R&D department
Goal	Survival	Growth	Internal stability, market expansion	Reputation, complete organization
Top management style	Individualistic, entrepreneurial	Charismatic, direction-giving	Delegation with control	Team approach, attack bureaucracy

Source: Adapted from Larry E. Greiner, "Evolution and Revolution as Organizations Grow," *Harvard Business Review* 50 (July–August 1972), 37–46; G. L. Lippitt and W. H. Schmidt, "Crises in a Developing Organization," *Harvard Business Review* 45 (November–December 1967), 102–112; B. R. Scott, "The Industrial State: Old Myths and New Realities," *Harvard Business Review* 51 (March–April 1973), 133–148; and Robert E. Quinn and Kim Cameron, "Organizational Life Cycles and Shifting Criteria of Effectiveness," *Management Science* 29 (1983), 33–51.

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Elaboration. The mature organization is large and bureaucratic, with extensive control systems, rules, and procedures. Organization managers attempt to develop a team orientation within the bureaucracy to prevent further bureaucratization. Top managers are concerned with establishing a complete organization. Organizational stature and reputation are important. Innovation is institutionalized through an R&D department. Management may attack the bureaucracy and streamline it.

Summary. Growing organizations move through stages of a life cycle, and each stage is associated with specific characteristics of structure, control systems, goals, and innovation. The life-cycle phenomenon is a powerful concept used for understanding problems facing organizations and how managers can respond in a positive way to move an organization to the next stage.

REMEMBER THIS

- Organizations evolve through distinct life-cycle stages as they grow and mature. Organization structure, internal systems, and management issues are different for each stage of development. Growth creates crises and revolutions along the way toward large size.
- A major task of managers is to guide the organization through the entrepreneurial, collectivity, formalization, and elaboration stages of development.
- For technology companies and platform-based organizations, life cycles are getting shorter. Airbnb managers are currently coping with challenges at the formalization stage of development, creating new procedures and control systems to help the organization provide a more reliable experience for guests.

10.3 Organizational Size, Bureaucracy, and Control

As organizations progress through the life cycle, they usually take on bureaucratic characteristics as they grow larger and more complex. The systematic study of bureaucracy was launched by Max Weber, a sociologist who studied government organizations in Europe and developed a framework of administrative characteristics that would make large organizations rational and efficient.[41] Weber wanted to understand how organizations could be designed to play a positive role in the larger society.

10.3a What Is Bureaucracy?

Although Weber perceived **bureaucracy** as a threat to basic personal liberties, he also recognized it as the most efficient possible system of organizing. He predicted the triumph of bureaucracy because of its ability to ensure more efficient functioning of organizations in both business and government settings. Weber identified a set of organizational characteristics, shown in Exhibit 10.4, that could be found in successful bureaucratic organizations.

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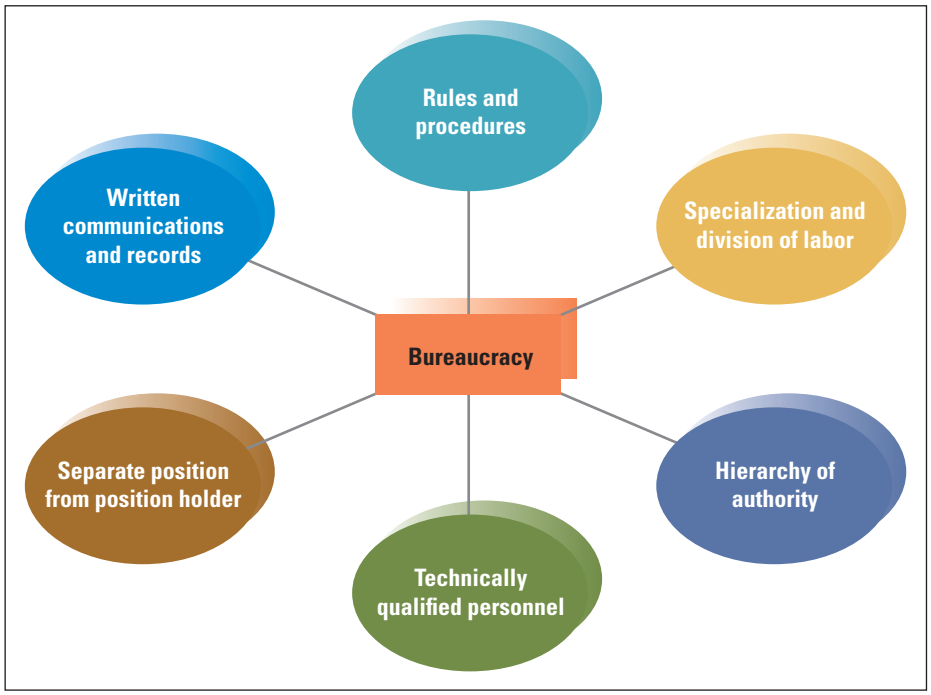
EXHIBIT 10.4
Weber's Dimensions of Bureaucracy



Rules and standard procedures enabled organizational activities to be performed in a predictable, routine manner. Specialized duties meant that each employee had a clear task to perform. Hierarchy of authority provided a sensible mechanism for supervision and control. Technical competence was the basis by which people were hired rather than friendship, family ties, and favoritism. The separation of the position from the position holder meant that individuals did not own or have an inherent right to the job, which promoted efficiency. Written records provided an organizational memory and continuity over time.

Although bureaucratic characteristics carried to an extreme are widely criticized today, the rational control introduced by Weber was a significant idea and a new form of organization. Bureaucracy provided many advantages over organization forms based on favoritism, social status, family connections, or graft. For example, in China, the tradition of giving government posts to relatives is still widespread, but China's emerging class of educated people doesn't like seeing the best jobs going to children and other relatives of officials.[42] The United States, as well, sees its share of corruption, as evidenced by the case of Illinois Governor Rod Blagojevich, who was accused of a wide-ranging corruption that included trying to sell the Senate seat vacated by President Barack Obama.[43] By comparison with these examples, the logical and rational form of organization described by Weber allows work to be conducted fairly, efficiently, and according to established rules.

A study of empirical organization research over four decades confirms the validity and persistence of Weber's model of bureaucracy, showing positive relationships among elements such as specialization, formalization, and standardization, as shown in Exhibit 10.4.[44] Bureaucratic characteristics can have a positive effect for many large organizations, such as United Parcel Service (UPS), one of today's most efficient large corporations.

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Rick Lewis/Alamy Stock Photo

IN PRACTICE

United Parcel Service (UPS)

UPS, sometimes called *Big Brown* for the color of delivery trucks and employee uniforms, is the largest package-distribution company in the world, delivering nearly 16 million packages a day, and a global leader in supply chain, logistics, and information services. The company operates in more than 200 countries and territories around the world.

How did UPS become so successful? Many efficiencies were realized through adoption of the bureaucratic model of organization. UPS operates according to a mountain of rules and regulations. It teaches drivers an astounding 340 precise steps to correctly deliver a package. For example, it tells them how to load their trucks, how to unbuckle their seat belts (with the left hand), how to step off the truck, how to walk (briskly, but no running), and how to carry their keys. A software program designs the most efficient route for each truck. By avoiding to the extent possible left-hand turns against the flow of traffic on right-hand driving roads such as those in the United States, UPS saves 10 million gallons of fuel each year. Strict dress codes are enforced—clean uniforms (called *browns*) every day, black or brown polished shoes with nonslip soles, no shirt unbuttoned below the first button, no hair below the shirt collar, no beards, no tattoos visible during deliveries, and so on. Before each shift, drivers conduct a "Z-scan," a Z-shaped inspection of the sides and front of their vehicles. There are safety rules for drivers, loaders, clerks, and managers. Employees are asked to clean off their desks at the end of each day so they can start fresh the next morning. Managers are given copies of policy books with the expectation that they will use them regularly, and memos on various policies and rules circulate by the hundreds every day.

Despite the strict rules and numerous policies, employees are satisfied and UPS has a high employee retention rate. Employees are treated well and paid well, and the company has maintained a sense of equality and fairness. Everyone is on a first-name basis. The policy book states, "A leader does not have to remind others of his authority by use of a title. Knowledge, performance, and capacity should be adequate evidence of position and leadership." Technical qualification, not favoritism, is the criterion for hiring and promotion. Top executives started at the bottom—current Chairman and CEO David Abney began his career as a part-time package loader while he was in college. The emphasis on equality, fairness, and a promote-from-within mentality inspires loyalty and commitment throughout the ranks.[45]

UPS illustrates how bureaucratic characteristics increase with large size. UPS is so productive and dependable that it dominates the small package delivery market. As it expands and transitions into a global, knowledge-based logistics business, UPS managers may need to find effective ways to reduce the bureaucracy. New technology and new services place more demands on workers, who may need more flexibility and autonomy to perform well. Now, let's look at some specific ways size affects organization structure and control.

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BRIEFCASE

As an organization manager, keep these guidelines in mind:

As the organization grows, provide greater formalization to achieve standardization and control. Guard against excessive overhead by keeping administrative, clerical, and support staff costs low.

10.3b Size and Structural Control

In the field of organization theory, organization size has been described as an important contingency that influences structural design and methods of control. Should an organization become more bureaucratic as it grows larger? In what size organizations are bureaucratic characteristics most appropriate? More than 100 studies have attempted to answer these questions.[46] Most of these studies indicate that large organizations are different from small organizations along several dimensions of bureaucratic structure, including formalization, centralization, and personnel ratios.

Formalization and Centralization. **Formalization**, as described in Chapter 1, refers to rules, procedures, and written documentation, such as policy manuals and job descriptions, that prescribe the rights and duties of employees.[47] The evidence supports the conclusion that large organizations are more formalized, as at UPS. The reason is that large organizations rely on rules, procedures, and paperwork to achieve standardization and control across their large numbers of employees and departments, whereas top managers can use personal observation to control a small organization.[48] For example, a locally-owned coffee shop in a small town doesn't need the detailed manuals, policies, and procedures that Starbucks uses to standardize and control its operations around the world.

Centralization refers to the level of hierarchy with authority to make decisions. In centralized organizations, decisions tend to be made at the top. In decentralized organizations, similar decisions would be made at a lower level.

Decentralization represents a paradox because, in the perfect bureaucracy, all decisions would be made by the top administrator, who would have perfect control. However, as an organization grows larger and has more people and departments, decisions cannot be passed to the top because senior managers would be overloaded. Thus, the research on organization size indicates that larger organizations permit greater decentralization.[49] In small startup organizations, on the other hand, the founder or top executive can effectively be involved in every decision, large and small.

Personnel Ratios. Another characteristic of bureaucracy relates to **personnel ratios** for administrative, clerical, and professional support staff. The most frequently studied ratio is the administrative ratio.[50] Two patterns have emerged. The first is that the ratio of top administration to total employees is typically smaller in large organizations,[51] indicating that organizations experience administrative economies as they grow larger. The second pattern concerns clerical and professional support staff ratios.[52] These groups tend to *increase* in proportion to organization size. Studies of large colleges and universities have found that the number of administrators including clerical and professional support staff has grown eight to ten times as much over the past decade as the number of faculty. According to the U.S. Department of Education, the number of employees hired by institutions of higher education to manage people, programs, and regulations grew 50 percent faster than the number of instructors between 2001 and 2011.[53] The clerical ratio increases because of the greater communication and reporting requirements needed as organizations grow larger. The professional staff ratio increases because of the greater need for specialized skills in larger, more complex organizations.

Exhibit 10.5 illustrates administrative and support ratios for small and large organizations. As organizations increase in size, the administrative ratio declines and the ratios for other support groups increase.[54] The net effect for

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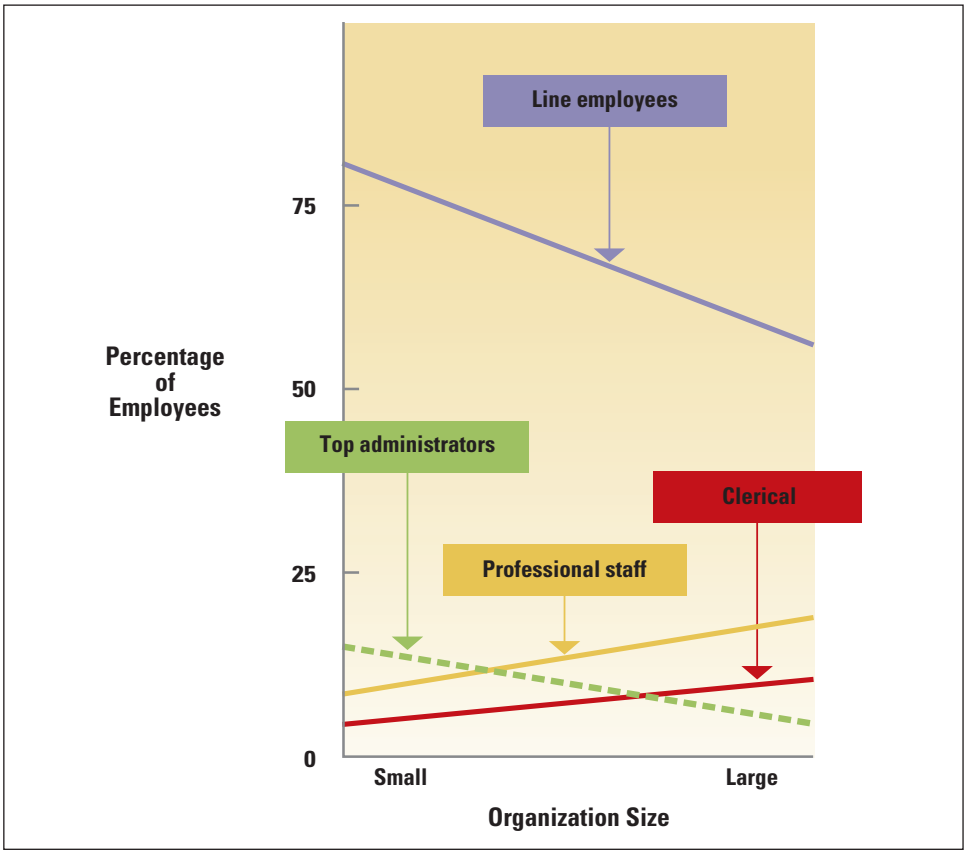

EXHIBIT 10.5
Percentage of Personnel Allocated to Administrative and Support Activities

direct workers is that they decline as a percentage of total employees. In summary, whereas top administrators do not make up a disproportionate number of employees in large organizations, the idea that proportionately greater overhead is required in large organizations is supported. Keeping costs for administrative, clerical, and professional support staff low represents an ongoing challenge for large organizations.

REMEMBER THIS

- As organizations progress through the life cycle and grow larger and more complex, they generally take on bureaucratic characteristics, such as rules, division of labor, written records, hierarchy of authority, and impersonal procedures.
- Bureaucracy is a logical form of organizing that lets firms use resources efficiently.
- Large organizations are more formalized than small organizations, relying on rules, procedures, and paperwork to achieve standardization and control.
- Personnel ratios tend to change as organizations grow in size, producing increases in the percentage of clerical and professional staff and decreases in the percentage of line employees and top administrators.

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10.4 Bureaucracy in a Changing World

Weber's prediction of the triumph of bureaucracy proved accurate. Bureaucratic characteristics have many advantages and have worked extremely well for many of the needs of the industrial age.[55] By establishing a hierarchy of authority and specific rules and procedures, bureaucracy provides an effective way to bring order to large groups of people and minimize abuses of power. This chapter's BookMark describes a technology startup where leaders did away with "the trappings of bureaucracy" and then had to reinstate some of those trappings at the urging of their employees. Bureaucracy provides for systematic and rational ways to organize and manage tasks too complex to be understood and handled by a few individuals, thus greatly improving the efficiency and effectiveness of large organizations. Impersonal relationships based on roles rather than people also reduced the favoritism and nepotism characteristic of many pre-industrial organizations.

BOOKMARK 10.0 HAVE YOU READ THIS BOOK?

The Conversational Firm: Rethinking Bureaucracy in the Age of Social Media

By Catherine J. Turco

Two tech-savvy millennials started a social media marketing firm. With a desire to extend the open communication and dialogue enabled by social media into the management of their company, the founders built "radical openness" into the fabric of the organization—leaders share everything with people throughout the company, including not only proposed projects but sensitive information such as detailed financial statements and projections, the equity structure of the company, and employee vacation requests, and invite everyone to share their information, ideas, and opinions. Catherine Turco, a professor at the MIT Sloan School of Management, spent 10 months studying the company, which she calls TechCo in her ethnographic account *The Conversational Firm: Rethinking Bureaucracy in the Age of Social Media*.

THE POWER OF "HAVING A VOICE"

Turco says she came to realize that what employees really want is to have a voice—to be listened to and consulted, whether or not their demands are met or their ideas are implemented. TechCo's management structure is a mix that emerged and continues to evolve because the founder-leaders "attack[ed] the bureaucratic firm's structure of communication while leaving the structure of authority largely intact." TechCo uses a fairly conventional hierarchy when it comes to decision-making authority, but everyone gets to have a say. The company promotes conversation in both digitally and physically open spaces. TechCo uses multiple communication channels, including an internal wiki, chat forums, large open meetings, and hack nights to encourage people to speak out. The company is continually adopting new technology to increase conversation. Moreover, the workplace consists of large open bullpens, and TechCo's 600 or so employees switch workstations every quarter. Leaders sit with everyone else rather than behind closed doors. Employees say that is particularly important because it shows that the leaders truly want open communication and sharing. Building a conversational firm also requires that leaders show that they value employees' ideas and opinions.

DO PEOPLE NEED SOME ELEMENTS OF BUREAUCRACY?

One of the most interesting parts of Turco's book concerns how leaders gave in to employee demands to add some bureaucratic practices. "Employees did not just play along [with leaders' decisions]," Turco writes. "Rather, they voiced their criticisms loudly and clearly through all the various points of openness the company had in place." For example, employees said, "We want an organization chart and a human resources department." TechCo's founder-leaders hated the idea of creating a formal organization chart, but they finally did so after employees kept saying they needed it to help them understand who runs what and who reports to whom. Similarly, the leaders refused to create an HR department for several years, but they finally gave in to employee demands. Employees said the lack of standards around issues such as performance reviews, leave policies, internal job changes, and other HR matters was driving them mad.

CONCLUSION

Turco concludes that TechCo reflects a unique management approach to reducing bureaucracy, and she reminds us all "that we can rethink the conventional bureaucratic firm by rethinking communication."

The Conversational Firm: Rethinking Bureaucracy in the Age of Social Media, by Catherine J. Turco, is published by Columbia University Press.

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However, the machine-like bureaucratic system of the industrial age doesn't always work so well as organizations face new challenges and need to respond quickly. The Vatican's bureaucracy, for example, has been blamed for the inability of the Catholic Church to respond to and better serve its members. Pope Francis is only the latest of popes who have tried for decades—and, so far, failed—to change the Vatican. "Instead of transforming the structure," said a former superior general of a Roman Catholic religious order, "the structure transforms you." Communication among the various departments moves at a snail's pace.[56]

Businesses have the same problem. Researchers Gary Hamel and Michele Zanini surveyed 7,000 people to determine how bureaucracy affected their work and found a decided increase in the number of days it takes to get a decision as companies grow larger. In organizations with 100 to 1,000 employees, the average number of days needed to get a decision about a non-budgeted expenditure was about 15. In organizations with 5,000 or more employees, the time required had increased to 20 days.[57] At Microsoft, some employees say getting approval for even routine matters can take weeks. One employee left the company because he was tired of being inundated with paperwork. "The smallest issue would balloon into a nightmare of a thousand e-mails," he says.[58] Managers are trying to find ways to cut the bureaucracy so people can do their jobs more effectively and help Microsoft stay competitive. Like Microsoft, many organizations are fighting against increasing formalization and professional staff ratios.

The problems caused by over-bureaucratization are evident in the inefficiencies of some large U.S. government organizations. One study found an average of 18 Federal management layers between the top and bottom of most agencies, such as between the Secretary of Agriculture and the forest ranger or the Secretary of the Interior and the oil rig inspector.[59] Some agencies have so many clerical staff members and confusing job titles that no one is really sure who does what. Richard Cavanagh, once an aide to President Jimmy Carter, reports his favorite Federal title as the "administrative assistant to the assistant administrator for administration of the General Services Administration."[60] Some critics have blamed government bureaucracy for intelligence, communication, and accountability failures related to the 2001 terrorist attacks, the Columbia space shuttle disaster, the abuses at Abu Ghraib prison, and slow responses to the 2010 Gulf oil spill and the 2012 Hurricane Sandy disasters. "Every time you add a layer of bureaucracy, you delay the movement of information up the chain of command. . .. And you dilute the information because at each step some details are taken out," says Richard A. Posner, a Federal appeals court judge who has written a book on intelligence reform.[61] Many business organizations, too, need to reduce formalization and bureaucracy. Narrowly defined job descriptions and excessive rules, for example, tend to limit the creativity, flexibility, and rapid response needed in today's knowledge-based organizations.

10.4a Organizing Temporary Systems

How can organizations overcome the problems of bureaucracy in rapidly changing environments? Some are implementing innovative structural solutions. One structural concept is to use temporary systems or structures to respond to an emergency or crisis situation. This approach is often used by organizations such as police and fire departments or other emergency management agencies to maintain

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BRIEFCASE

As an organization manager, keep these guidelines in mind:

Consider using a temporary systems approach to maintain the efficiency and control benefits of bureaucracy but prevent the problem of slow response to rapid environmental change. Enable the organization to glide smoothly from a formalized system during times of stability to a more flexible, loosely structured one when facing threats, crises, or unexpected environmental changes.

the efficiency and control benefits of bureaucracy, yet prevent the problem of slow response.[62] The approach is being adapted by other types of organizations to help them respond quickly to new opportunities, unforeseen competitive threats, or organizational crises.

The basic idea is that the organization can glide smoothly between a highly formalized, hierarchical structure that is effective during times of stability and a more flexible, loosely structured one needed to respond well to unexpected and demanding environmental conditions. The hierarchical side with its rules, procedures, and chain of command helps maintain control and ensure adherence to rules that have been developed and tested over many years to cope with well-understood problems and situations. During times of high uncertainty, however, the most effective structure is one that loosens the lines of command and enables people to work across departmental and hierarchical lines to anticipate, avoid, and solve unique problems within the context of a clearly understood mission and guidelines. The approach can be seen in action at the Salvation Army, which has been called "the most effective organization in the world."

IN PRACTICE

Salvation Army

The Salvation Army provides day-to-day assistance to the homeless and economically disadvantaged. In addition, the organization rushes in whenever there is a major disaster—whether it be a tornado, flood, hurricane, airplane crash, or terrorist attack—to network with other agencies to provide disaster relief. The Army's management realizes that emergencies demand high flexibility. At the same time, the organization must have a high level of control and accountability to ensure its continued existence and meet its day-to-day responsibilities. As a former national commander puts it, "We have to have it both ways. We can't choose to be flexible and reckless or to be accountable and responsive. . ., we have to be several different kinds of organization at the same time."

In the early emergency moments of a crisis, the Salvation Army deploys a temporary organization that has its own command structure. People need to have a clear sense of who's in charge to prevent the rapid response demands from degenerating into chaos. For example, when the Army responds to a disaster such as the 2019 flooding and tornadoes across the Midwest, manuals clearly specify in advance who is responsible for talking to the media, who is in charge of supply inventories, who liaises with other agencies, and so forth. This model for the temporary organization keeps the Salvation Army responsive and consistent. However, in the later recovery and rebuilding phases of a crisis, supervisors frequently give people general guidelines and allow them to improvise the best solutions. There isn't time for supervisors to review and sign off on every decision that needs to be made to get families and communities re-established.

Thus, the Salvation Army actually has people simultaneously working in all different types of structures, from traditional vertical command structures, to horizontal teams, to a sort of network form that relies on collaboration with other agencies. Operating in such a fluid way enables the organization to accomplish amazing results. In one year, the Army assisted more than 2.3 million people caught in disasters in the United States, in addition to many more served by regular day-to-day programs. It has been recognized as a leader in putting money to maximal use, meaning donors are willing to give because they trust the organization to be responsible and accountable, whilst at the same time being flexible and innovative in meeting human needs.[63]

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10.4b Other Approaches to Busting Bureaucracy

Organizations are taking a number of other, less dramatic steps to reduce bureaucracy, often driven by top leaders. Many are cutting layers of the hierarchy, keeping headquarters staff small, and giving lower-level employees greater freedom to make decisions rather than burdening them with excessive rules and regulations. The commitment of top leadership is essential when an organization needs to reduce bureaucracy and become more flexible and responsive.[64] Consider the following examples:

- As described at the beginning of Chapter 1 of this text, when Jack Welch was first hired as an engineer at General Electric, he hated the company's bureaucracy so much that he submitted his resignation after only six months on the job. When he later became CEO, Welch attacked the GE bureaucracy by slashing layers of management and stretching the span of control of managers to push more delegation and autonomy downward. He implemented various practices, including a team practice called Work-Out, to create a corporate culture based on direct conversations of openness and candor between managers and direct reports rather than through formal meetings and bureaucratic paperwork. Welch continued to fight bureaucracy throughout his career at GE.
- After stepping aside from the CEO job at Google in 2001, co-founder Larry Page returned 10 years later to try to cut through the bureaucracy that had built up as Google became a big corporation. He eventually led the company through a dramatic restructuring in which Google and other businesses were split into separate, smaller companies under the parent company Alphabet, as described in Chapter 3 of this text. Page undertook the restructuring to give each firm greater autonomy, flexibility, and freedom. He also implemented various mechanisms to speed decision making and restore the sense of a startup. Page, who now serves as CEO of Alphabet, is known to walk around the offices asking people all kinds of questions about how they do their jobs. Employees like that Page "acts on the same level as other employees" and shows that he is interested in their ideas and work. "The more people say that you can't have a big company act like a small company, the more determined [Larry Page] is to figure out how to do just that," said Steven Levy, the author of a book about Google.[65]
- At the London-based pharmaceuticals company GlaxoSmithKline PLC, top executives gave frontline scientists, not managers or a research committee, the authority to set priorities and allocate resources for drugs in development. The shift in who decides which drug research projects to fund has brought an entrepreneurial spirit to the giant firm similar to that of a small biotechnology company.[66]

Another attack on bureaucracy is from the increasing professionalism of employees. **Professionalism** is defined as the length of formal training and experience of employees. More employees need college degrees, MBAs, and other professional degrees to work as attorneys, researchers, engineers, or doctors at Google, Zurich Insurance Group, or GlaxoSmithKline. Some Internet-based companies are staffed entirely by well-educated knowledge workers. Studies of professionals show that formalization is not needed because professional training regularizes a high standard of behavior for employees, which acts as a substitute for bureaucracy.[67] Companies enhance this trend when they provide ongoing training for *all* employees, from the front office to the shop floor, in a push for continuous individual and organizational learning. Increased training substitutes for bureaucratic rules and

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procedures that can constrain the creativity of employees in solving problems and also enhances individual and organizational capability.

A form of organization called the *professional partnership* is made up completely of professionals.[68] These organizations include accounting firms, medical practices, law firms, and consulting firms. The general finding concerning professional partnerships is that branches have substantial autonomy and decentralized authority to make necessary decisions. They work with a consensus orientation rather than the top-down direction typical of traditional business and government organizations. Thus, the trend of increasing professionalism combined with rapidly changing environments is leading to less bureaucracy in corporate North America.

REMEMBER THIS

- In many large corporate and government organizations, bureaucracy has come under attack with attempts to decentralize authority, flatten organization structure, reduce rules and written procedures, and create a small-company mindset. These companies are willing to trade economies of scale for responsive, adaptive organizations.
- One study found that in organizations with 100 to 1,000 employees, the average number of days needed to get a decision about a non-budgeted expenditure was about 15, but in organizations with 5,000 or more employees, the time required increased to 20 days.
- Many companies are subdividing to gain small-company advantages. Another approach to overcoming the problems of bureaucracy is to use temporary systems, enabling the organization to glide smoothly between a highly formalized, hierarchical style that is effective during times of stability and a more flexible, loosely structured one needed to respond to unexpected or volatile environmental conditions.
- Another attack on bureaucracy is from the increasing professionalism of employees, which refers to the formal training and experience of employees. Studies of professionals show that formalization is not needed because professional training regularizes a high standard of behavior for employees, which acts as a substitute for bureaucracy.

10.5 Bureaucracy and Other Forms of Control

Even though many organizations are trying to reduce bureaucracy and streamline rules and procedures that constrain employees, every organization needs systems for guiding and controlling the organization. Employees may have more freedom in today's companies, but control is still a major responsibility of management.

Managers at the top and middle levels of an organization can choose among three overall control strategies. These strategies come from a framework for organizational control proposed by William Ouchi of the University of California at Los Angeles. Ouchi suggested three control strategies that organizations could adopt—bureaucratic, market, and clan.[69] Each form of control uses different types of information. However, all three types may appear simultaneously in an organization. The requirements for each control strategy are given in Exhibit 10.6.

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10.5a Bureaucratic Control

Bureaucratic control is the use of rules, policies, hierarchy of authority, written documentation, standardization, and other bureaucratic mechanisms to standardize behavior and assess performance. Bureaucratic control uses the bureaucratic characteristics defined by Weber and illustrated in the UPS case. The primary purpose of bureaucratic rules and procedures is to standardize and control employee behavior.

Recall that as organizations progress through the life cycle and grow larger, they become more formalized and standardized. Within a large organization, thousands of work behaviors and information exchanges take place both vertically and horizontally. Rules and policies evolve through a process of trial and error to regulate these behaviors. Some degree of bureaucratic control is used in virtually every organization. Rules, regulations, and directives contain information about a range of behaviors. For example, note the variety of behaviors managers seek to control through the rules at an exclusive yacht club, listed in Exhibit 10.7.

To make bureaucratic control work, managers must have the authority to maintain control over the organization. Weber argued that legitimate, rational authority granted to managers was preferred over other types of control (e.g., favoritism or payoffs) as the basis for organizational decisions and activities. Within the larger society, however, Weber identified three types of authority that could explain the creation and control of a large organization.[70]

Rational–legal authority is based on employees' belief in the legality of rules and the right of those elevated to positions of authority to issue commands. Rational–legal authority is the basis for both creation and control of most government organizations and is the most common base of control in organizations worldwide.

EXHIBIT 10.6
Three Organizational Control Strategies

Type	Requirements
Bureaucratic	Rules, standards, hierarchy, legitimate authority
Market	Prices, competition, exchange relationship
Clan	Tradition, shared values and beliefs, trust

Source: Based on William G. Ouchi, "A Conceptual Framework for the Design of Organizational Control Mechanisms," *Management Science* 25 (1979), 833–848.

EXHIBIT 10.7
Examples of Rules at a Yacht Club

Northeast Harbor Yacht Club Rules for Employees

- Employees shall maintain a clean and well-dressed appearance at work.
- The summer uniform is green shorts, black or brown belt, white shirt tucked in, and boat shoes. Frayed clothing is not allowed at the club.
- Employees should arrive at work at or before the agreed-upon shift time.
- Employees shall not smoke or consume alcohol on club property at any time.
- Employees are required to be polite and helpful to members at all times.
- Employees should remain a respectful distance from members and should not accept social invitations from members.
- Employees should not be on club property when they are not working.
- Employees are not permitted to use the club phones to make or receive personal calls.
- Instructors must provide their own manuals and radio.
- Maintenance employees must provide and use their own tools.

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Traditional authority is the belief in traditions and in the legitimacy of the status of people exercising authority through those traditions. Traditional authority is the basis for control for monarchies, churches, and some organizations in Latin America and the Persian Gulf. **Charismatic authority** is based on devotion to the exemplary character or to the heroism of an individual person and the order defined by him or her. Revolutionary military organizations are often based on the leader's charisma, as are North American organizations led by charismatic individuals such as Elon Musk, the entrepreneur behind Tesla Motors and SpaceX, and media entrepreneur Oprah Winfrey, who started a successful TV show and magazine, and is now a media executive and TV producer.

More than one type of authority—such as long tradition and the leader's special charisma—may exist in organizations, but rational–legal authority is the most widely used form to govern internal work activities and decision making, particularly in large organizations. Bureaucratic control can be highly effective, and rules and standardization are important when safety is at stake. "The existence of rules and regulations, and the bureaucrats who enforce them . . . puts a check on the kinds of initiatives that can lead to catastrophe."[71] Newell Rubbermaid, for example, carefully follows standard procedures for building and testing car seats and strollers for infants. Also consider environmental safety in drilling the Marcellus Shale, a vast underground rock formation rich in natural gas.

IN PRACTICE

East Resources Inc. and Royal Dutch Shell PLC

East Resources Inc. was among the first companies to drill into the Marcellus Shale, starting in 2008, and regulators cited the company for spills or other environmental infractions repeatedly. Then, Royal Dutch Shell bought East Resources and brought its bureaucratic control to the operation.

The first thing Shell did was shut down the rigs and retrain all the workers. Since taking over, Shell has averaged less than one violation for every four wells. The same pattern can be seen across the Marcellus Shale. As larger companies with standardized procedures buy out smaller firms, environmental and safety records are improving. The larger firms have developed more rigorous approaches because they know that even one mistake can affect their ability to do business in all areas. Most of these companies have learned from the BP Deepwater Horizon oil spill disaster that it is better to be safe than sorry. Smaller firms typically use riskier procedures. Inspection records show that large companies such as Shell, Exxon, and Chevron averaged 38 violations for every 100 Marcellus wells they drilled. Mid-sized companies averaged 69 citations per 100 wells; and the smallest firms averaged 139 citations per 100 wells.[72]

Of course, some companies have also found that too many rules can get in the way of serving customers. For example, consistency is important for any company, and rules and procedures that facilitated predictable outcomes enabled Starbucks to grow from six stores in 1987 to a huge corporation with thousands of stores around the world. However, applying rules inflexibly and blindly soon started to cause problems. One software entrepreneur and *Inc.* magazine contributor tells a story about an order taker in a Starbucks store who got into a prolonged shouting match with a customer who wanted to pick up her sandwich at the front counter. "They're not allowed to give it to you up here!" the employee kept shouting at the shocked and frustrated customer.[73] Managers are always looking for the best combination of rules and flexibility to meet customer service goals.

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10.5b Market Control

Market control occurs when price competition is used to evaluate the output and productivity of an organization or its major departments and divisions. The idea of market control originated in economics.[74] A dollar price is an efficient form of control because managers can compare prices and profits to evaluate the efficiency of the corporation. Top managers nearly always use the price mechanism to evaluate performance in their corporations. Corporate sales and costs are summarized in a profit-and-loss statement that can be compared against performance in previous years or with that of other corporations.

The use of market control requires that outputs be sufficiently explicit for a price to be assigned and that competition exists. Without competition, the price does not accurately reflect internal efficiency. Even some government and nonprofit organizations are effectively using market control. For example, the U.S. Federal Aviation Administration took bids to operate its payroll computers. The Department of Agriculture beat out IBM and two other private companies to win the bid.[75] The city of Indianapolis requires all its departments to bid against private companies. When the transportation department was underbid by a private company on a contract to fill potholes, the city's union workers made a counterproposal that involved eliminating most of the department's middle managers and re-engineering union jobs to save money. Eighteen supervisors were laid off, costs were cut by 25 percent, and the department won the bid.[76]

Market control was once used primarily at the level of the entire organization, but it is increasingly used in product divisions or individual departments. Profit centers are self-contained product divisions, such as those described in Chapter 3. Each division contains resource inputs needed to produce a product. Each division can be evaluated on the basis of profit or loss compared with other divisions. ABB, a global electrical contractor and manufacturer of electrical equipment, includes three different types of profit centers, all operating according to their own bottom line and all interacting through buying and selling with one another and with outside customers.[77] The network organization, also described in Chapter 3, illustrates market control as well. Different companies compete on price to provide the functions and services required by the hub organization. The organization typically contracts with the company that offers the best price and value.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Implement one of the three basic choices—bureaucratic, clan, market—as the primary means of organizational control. Use bureaucratic control when organizations are large, have a stable environment, and use routine technology. Use clan control in small, uncertain departments. Use market control when outputs can be priced and when competitive bidding is available.

10.5c Clan Control

Clan control is the use of social characteristics, such as shared values, commitment, traditions, and beliefs, to control behavior. Organizations that use clan control have strong cultures that emphasize shared values and trust among employees.[78] Clan control is important when ambiguity and uncertainty are high. High uncertainty means the organization cannot put a price on its services, and things change so fast that rules and regulations are not able to specify every correct behavior. Under clan control, people may be hired because they are committed to the organization's purpose, such as in a religious organization or an organization focused on a social mission. New employees are typically subjected to a long period of socialization to gain acceptance by colleagues. There is strong pressure to conform to group norms, which govern a wide range of employee behaviors. Managers act primarily as mentors, role models, and agents for transmitting values.[79]

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ASSESS YOUR ANSWER

2 A manager should emphasize shared values, trust, and commitment to the organization's mission as the primary means of controlling employee behavior.

ANSWER: *Agree* or *disagree.* Clan control, which relies on culture, trust, commitment, and shared values and traditions, can be highly effective and is particularly useful in departments or organizations experiencing high uncertainty or environmental turbulence. However, other forms of control, such as bureaucratic or market control, are also effective and appropriate under the right circumstances.

Traditional control mechanisms based on strict rules and close supervision are inadequate for controlling behavior in conditions of high uncertainty and rapid change.[80] In addition, the use of computer networks and the Internet, which often leads to a democratic spread of information throughout the organization, is influencing companies to depend less on bureaucratic control and more on shared values that guide individual actions for the corporate good.[81]

A similar concept is *self-control*. Whereas clan control is a function of being socialized into a group, self-control stems from individual values, goals, and standards. Managers attempt to induce a change such that individual employees' own internal values and work preferences are brought in line with the organization's values and goals.[82] With self-control, employees generally set their own goals and monitor their own performance, yet companies relying on self-control need strong leaders who can clarify boundaries within which people exercise their own knowledge and discretion.

Clan control or self-control may also be used in some departments, such as strategic planning, where uncertainty is high and performance is difficult to measure. Managers of departments that rely on these informal control mechanisms must not assume that the absence of written, bureaucratic control means no control is present. Clan control is invisible yet very powerful. One study found that the actions of employees were controlled even more powerfully and completely with clan control than with a bureaucratic hierarchy.[83] When clan control works, bureaucratic control is not needed, as managers at some "bossless" companies, such as those described in Chapter 1 of this text, have learned. Consider how clan control and self-control work at Valve Corporation.

IN PRACTICE

Valve Corporation and FAVI

Gabe Newell and Mike Harrington, the co-founders of Valve Corporation, wanted to create an organization that allowed employees maximum flexibility to create innovative video games. As one employee described it in a blog, "Valve was designed as a company that would attract the sort of people capable of taking the initial creative step, leave them free to do creative work, and make them want to stay."

At Valve, people choose which projects to work on. There are no assigned managers or bosses, and team "leads" are chosen by informal consensus within each project. Team members also work together to make decisions about how often to meet, how to test products, and the best way to achieve goals. If there are disagreements that can't be resolved within the team, "then it's up to their peers to point that out and get them back on track." Valve also uses a peer-review performance system. People evaluate and rank one another's performance. Top performers get generous bonuses and pay raises.

Self-control and clan control have worked just fine at Valve, which is a small technology-based company. These forms of control can also work in other types of

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organizations. One large company that shifted from a traditional bureaucratic control approach to a system based primarily on clan control is FAVI. When CEO Jean-François Zobrist took over FAVI, a 600-person French company that designs and manufactures automotive components, he eliminated the traditional hierarchy. There is no personnel department, no middle management, no time clocks, no employee handbooks. "I told them 'tomorrow when you come to work, you do not work for me or for a boss. You work for your customer. I don't pay you. They do.'" FAVI hasn't been late with a customer order in 10 years.[84]

One key for effective clan control is establishing strong clan-type values that guide employee behavior. Managers' approach to control is changing in many organizations. In connection with the shift to more collaborative forms of working and the trend toward bossless organization design, many companies are adopting a *decentralized* approach more in line with clan control rather than a *hierarchical* process associated with bureaucratic control. Hierarchical and decentralized control methods will be discussed in detail in Chapter 11.

REMEMBER THIS

- All organizations, large and small, need systems for control. Managers can choose among three overall control strategies: bureaucratic, market, and clan.
- Bureaucratic control relies on standard rules and the rational–legal authority of managers.
- Market control is used where product or service outputs can be priced and competition exists.
- Clan control and self-control are associated with uncertain and rapidly changing organization processes. They rely on commitment, tradition, and shared values for control.
- Managers may use a combination of control approaches to meet the organization's needs. In general, today's companies are shifting from a hierarchical to a decentralized approach to control.

10.6 Organizational Decline

Earlier in the chapter, we discussed the organizational life cycle, which suggests that organizations are born, grow older, and eventually die. In this section, we examine the causes and stages of organizational decline. Size can become a burden for many organizations. General Motors collapsed under its own weight and had to go through bankruptcy and a forced restructuring. Not only was the company laboring under a financial burden of huge pension and healthcare obligations, but its cumbersome bureaucracy had made it hard for GM to connect with the needs of consumers. Regional managers said their ideas and suggestions for product changes or advertising approaches never reached decision makers or fell on deaf ears.[85] Nearly every organization goes through periods of temporary decline. In addition, a reality in today's environment is that for some companies, continual growth and expansion may not be possible.

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All around, we see evidence that some organizations have stopped growing, and many are scaling back or declining. Huge financial services firms such as Lehman Brothers and Bear Stearns disintegrated partly as a result of unfettered growth and ineffective control. Global financial corporations such as Citigroup, Barclays, Credit Suisse Group, and Deutsche Bank have been scaling back in recent years after decades of global expansion. Citigroup is getting out of retail banking in at least 20 countries. British banking and financial services giant HSBC Holdings PLC has pulled out of at least 83 businesses around the world since 2011.[86] Industrial conglomerate United Technologies recently decided to split into three smaller companies so each separate piece can focus on its core business. The smaller organizations will include Otis, which manufactures elevators and escalators, Carrier, which makes heating and cooling equipment, and United Technologies, which will focus on aerospace. Chairman and CEO Gregory Hayes said of the decision, "My view is: Focus ultimately leads to success."[87]

10.6a Definition and Causes

The term **organizational decline** is used to define a condition in which a substantial, absolute decrease in an organization's resource base occurs over time.[88] Organizational decline is often associated with environmental decline in the sense that an organizational domain experiences either a reduction in size (such as shrinkage in customer demand or erosion of a city's tax base) or a reduction in shape (such as a shift in customer demand). In general, the following three factors are considered responsible for causing organizational decline.

1. *Organizational atrophy.* Atrophy occurs when organizations grow older and become inefficient and overly bureaucratized. The organization's ability to adapt to its environment deteriorates. Often, atrophy follows a long period of success because an organization takes success for granted, becomes attached to practices and structures that worked in the past, and fails to adapt to changes in the environment.[89] A prime example is BlackBerry, which pioneered the smartphone revolution but failed to prepare for competition and changes in the market. Some warning signals for organizational atrophy include excess administrative and support staff, cumbersome administrative procedures, lack of effective communication and coordination, and outdated organizational structure.[90]
2. *Vulnerability.* Vulnerability reflects an organization's strategic inability to prosper in its environment. This often happens to small organizations that are not yet fully established. They are vulnerable to shifts in consumer tastes or in the economic health of the larger community. Some organizations are vulnerable because they are unable to define the correct strategy to fit the environment. Vulnerable organizations typically need to redefine their environmental domain to enter new industries or markets.
3. *Environmental decline or competition.* Environmental decline refers to reduced energy and resources available to support an organization. When the environment has less capacity to support organizations, the organization must either scale down operations or shift to another domain.[91] During tough economic times, for example, managers at the American Red Cross, Salvation Army, and other non-profit organizations often struggle to raise enough funds to cover expenses.[92] New competition and fast-shifting industries can also be a problem. Russ Solomon started Tower Records in the back of his father's Sacramento drug store in 1960. Its stores, with listening rooms, extensive inventories of all

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kinds of recordings, and knowledgeable staff, became meccas for music lovers in the 1970s and 1980s. Tower grew into a giant international music retailer, but with the arrival of digital music in the early 2000s, Tower was vulnerable. The high debt the company had taken on to fuel its rampant growth contributed to its decline. Tower filed for bankruptcy and liquidated in 2013.[93]

All three of these factors were involved in the deterioration of Eastman Kodak, once an American icon of the photographic industry.

Lenscap Photography/Shutterstock.com

IN PRACTICE
Eastman Kodak

Founded in 1880, Eastman Kodak became one of America's most well-known companies, helping to create the industry for camera film and then dominating it for decades. At its peak, Kodak employed 145,000 people worldwide. But a combination of factors led Kodak down a long and winding path to bankruptcy. The company filed for Chapter 11 in January 2012 and is a shadow of its former self. By 2018, the number of employees for Kodak was down to less than 6,000.

The primary causes of decline were competition and industry changes, but atrophy and vulnerability were also involved. Kodak actually invented one of the first digital cameras and spent hundreds of millions of dollars developing digital technology, but managers couldn't move forward when it came time to go to market for fear of cannibalizing their lucrative film business. Fujifilm had been competing aggressively with Kodak in the market for traditional film for several years, undercutting prices and adopting a low-cost strategy, and Fuji was quick to jump on the digital bandwagon.

Kodak began trying to fight back, but managers couldn't find the right strategy to compete in an increasingly digital world. In 2003, the company ceased investing in its traditional film business, alienating some long-time customers. It was too late getting into digital to compete with Fuji and other major digital players. A decision to bet on inkjet printers didn't go anywhere. Since 2004, Kodak has reported only one full year of profits. Although Kodak emerged from bankruptcy in 2013 and has made progress in some areas, such as an environmentally friendly photo printing plates business, overall revenue is still declining.[94]

When managers are hit with all three causes of decline, such as at Kodak, it is exceedingly difficult to survive. In some cases, the only option is to shut things down in an orderly fashion. In the next section, we examine the stages of organizational decline and some common mistakes managers make that can lead to dissolution.

10.6b A Model of Decline Stages

Based on an extensive review of organizational decline research, a model of decline stages has been proposed and is summarized in Exhibit 10.8. This model suggests that decline, if not managed properly, can move through five stages, resulting in organizational dissolution.[95]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Understand the causes and stages of decline. Be vigilant to detect signs of decline in the organization and take action as quickly as possible to reverse course. Quick action in the early stages prevents the organization from deteriorating to a stage-4 crisis, when a turnaround becomes much more difficult.

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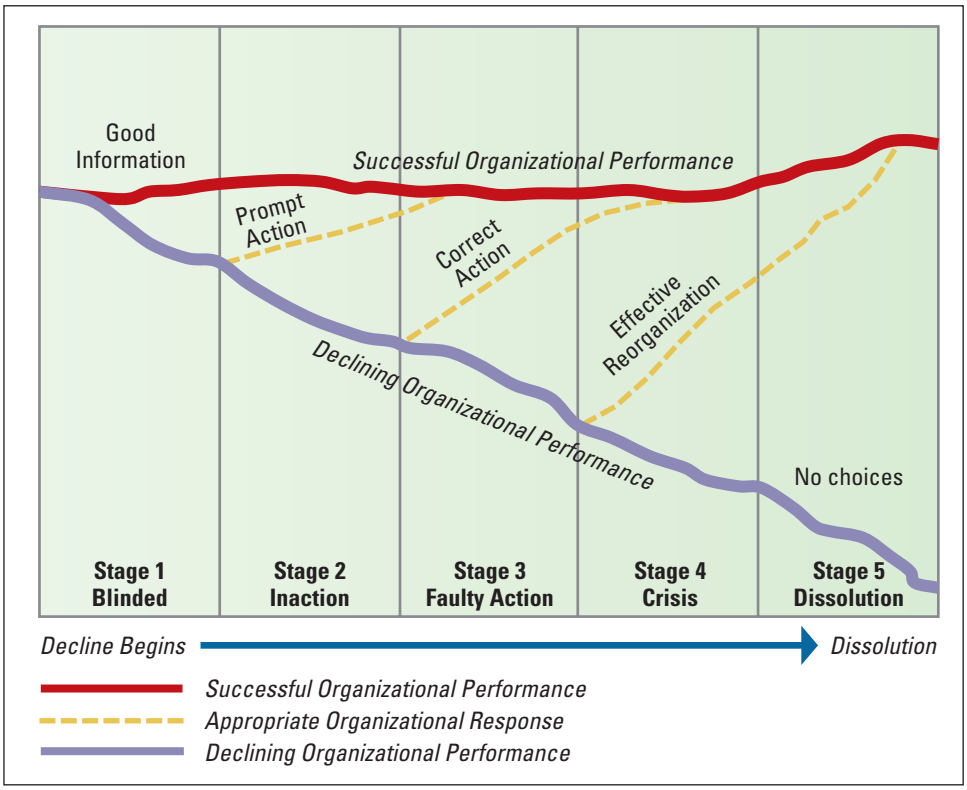
EXHIBIT 10.8
Stages of Decline and the Widening Performance Gap



Source: William Weitzel and Ellen Jonsson, "Decline in Organizations: A Literature Integration and Extension," *Administrative Science Quarterly* 34 (March 1989), 99–109. Reprinted by permission of SAGE Publications.

1. *Blinded stage*. The first stage of decline is the internal and external change that threatens long-term survival and may require the organization to tighten up. The organization may have excess personnel, cumbersome procedures, or lack of harmony with customers. Leaders often miss the signals of decline at this point, and the solution is to develop effective scanning and control systems that indicate when something is wrong. With timely information, alert executives can bring the organization back to top performance.
2. *Inaction stage*. The second stage of decline is called *inaction* in which denial occurs despite signs of deteriorating performance. Leaders may try to persuade employees and other stakeholders that all is well. In some cases, managers use "creative accounting" to make things look fine during this period. The solution is for leaders to acknowledge decline and take prompt action to realign the organization with the environment. Leadership actions may include adopting new problem-solving approaches, increasing decision-making participation, and encouraging employee and customer expression of dissatisfaction to learn what is wrong.

ASSESS YOUR ANSWER

3 If an organization starts into a state of decline, recovery is very unlikely.

ANSWER: *Disagree.* Any organization can experience a period of decline because of factors such as decreasing resources or other shifts in the environment. Managers are responsible for recognizing and effectively addressing decline before it is too late. In the early stages of decline, managers have time to correct problems and turn the organization around.

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3. *Faulty action stage*. In the third stage, the organization is facing serious problems, and indicators of poor performance cannot be ignored. Failure to adjust to the declining spiral at this point can lead to organizational failure. Leaders are forced by severe circumstances to consider major changes. Actions may involve retrenchment, including downsizing personnel. Leaders should reduce employee uncertainty by clarifying values and providing information. A major mistake at this stage decreases the organization's chance for a turnaround.
4. *Crisis stage*. In the fourth stage, the organization still has not been able to deal with decline effectively and is facing a panic. The organization may experience chaos, efforts to go back to basics, sharp changes, and anger. It is best for managers to prevent a stage-4 crisis; at this stage, the only solution is major reorganization. The social fabric of the organization is eroding, and dramatic actions are necessary, such as replacing top executives and instituting revolutionary changes in structure, strategy, and culture. Workforce downsizing may be severe.
5. *Dissolution stage*. This stage of decline is irreversible. The organization is suffering loss of markets and reputation, the loss of its best personnel, and capital depletion. The only available strategy is to close down the organization in an orderly fashion and reduce the separation trauma of employees.

Properly managing organizational decline is necessary if an organization is to avoid dissolution. Managers have a responsibility to detect the signs of decline, acknowledge them, implement necessary action, and reverse course. For example, Bed Bath & Beyond has been a successful housewares store with 1,500 locations jammed with merchandise. After 27 years of gains, suddenly in 2018 the chain lost $137 million dollars. A primary reason is the frugal, conservative management approach that prevented investment in online technology. Customers today can see thousands of products online and don't need to visit a store so packed with merchandise that items are hanging from the ceiling. Bed Bath & Beyond is in Stage 2 of decline because managers are coming to realize the need for corrective action. The managers can still save the chain if they can create and implement a new vision for the retailer.[96]

REMEMBER THIS

- Many organizations have stopped growing, and some are declining. Organizations go through stages of decline, including the blinded stage, the inaction stage, the faulty action stage, the crisis stage, and the dissolution stage.
- It is the responsibility of managers to detect the signs of decline, implement necessary action, and reverse course.

KEY CONCEPTS

bureaucracy
bureaucratic control
centralization
charismatic authority
clan control
collectivity stage
elaboration stage
entrepreneurial stage
formalization
formalization stage
life cycle
market control
organizational decline
personnel ratios
professionalism
rational–legal authority
traditional authority

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DISCUSSION QUESTIONS

1. Why do large organizations tend to have larger ratios of clerical and administrative support staff? Why are they typically more formalized than small organizations?
2. Apply the concept of life cycle to an organization with which you are familiar, such as a local business. What stage is the organization in now? How did the organization handle or pass through its life-cycle crises?
3. Why do you think organizations feel pressure to grow?
4. Describe the three bases of authority identified by Weber. Is it possible for each of these types of authority to function at the same time within an organization? Discuss.
5. Look through several recent issues of a business magazine such as *Fortune, Businessweek*, or *Fast Company* and find examples of two companies that are using approaches to busting bureaucracy. Discuss the techniques these companies are applying.
6. In writing about types of control, William Ouchi said, "The Market is like the trout and the Clan like the salmon, each a beautiful highly specialized species which requires uncommon conditions for its survival. In comparison, the bureaucratic method of control is the catfish—clumsy, ugly, but able to live in the widest range of environments and ultimately, the dominant species." Discuss what Ouchi meant with that analogy.
7. Government organizations often seem more bureaucratic than for-profit organizations. Could this partly be the result of the type of control used in government organizations? Explain.
8. How does the Salvation Army manage to be "several different kinds of organization at the same time"? Does the Salvation Army's approach seem workable for a large media company like Comcast or Disney that wants to reduce bureaucracy?
9. Numerous large financial institutions, including Lehman Brothers and Merrill Lynch, experienced significant decline or dissolution in recent years. Which of the three causes of organizational decline described in the chapter seems to apply most clearly to these firms?
10. Do you think a "no growth" philosophy of management should be taught in business schools? Discuss.

CHAPTER 10 WORKSHOP Classroom Control

Think back to one of your most favorite and least favorite courses in school. How did the instructor assert control over you, other students, and the classroom in those courses? **Write down your answers for the comparisons below.**

How were rules, standards, or formal authority used to influence student behavior?
Favorite class:
Least favorite class:
How were competition and grades used to influence student behavior?
Favorite class:
Least favorite class:
How were shared values, norms, and self-control used to influence student behavior?
Favorite class:
Least favorite class:

Form into teams of 3-4 students and discuss the following questions:

1. How did the differences in *type* of control used by the instructor influence how much you liked each course?
2. How did the *amount* of control asserted over students influence how much you liked each course?
3. How did size of each class influence the type and amount of control used by the instructor?

CASE FOR ANALYSIS | Yahoo!: *"Get to Work!"*

High-tech within the corporate world was developed, in part, on the notion of mobile strategy and convenience—the ability to communicate, work remotely and accomplish the same results; cutting the corporate and personal carbon footprint by reducing commute times; and reducing wasted time through workplace flexibility.

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Flex time was touted as a solution and an attractive perk for job seekers, particularly in the tech industries. Workers were actually *doing* and modeling what they insisted was possible for future workers. Then, it changed. Suddenly, the brakes were applied.

"Get to work" was what your mom said; what your coach said; what your teacher said. Suddenly, for Yahoo employees, it was what your boss said in a surprise memo from new CEO Marissa Mayer. *Entrepreneur* called it Mayer's "dumbest move," and it ignited a national debate over the concept of workplace bureaucracy versus flexibility.

Created by Stanford grad students Jerry Yang and David Filo, and launched as Yahoo in 1994, the company grabbed the spotlight, riding the dot-com bubble to both an all-time high and an all-time low in tech stock pricing, rejecting an acquisition bid from Microsoft, and suffering through its largest layoff of employees (2,000) in 2012. In a five-year period, 2009–2014, Yahoo had six CEOs bringing constantly changing visions and executives to the company.

In May 2013, Marissa Mayer came over from Google and immediately set off a fire-storm with the memo informing employees to get to work and announcing that Yahoo's work-at-home policy had been overturned. Empty parking lots, offices, and cubicles would henceforth be teeming with employees.

Seen by Mayer and a significant number of employees as a boost for low morale, the move was criticized by others within the company and across industries as a slap in the face at the notion of flexibility and remote workforce productivity.

The general target for the new corporate ruling appeared to be the 200 or so employees who had routinely abused the work-from-home privilege by doing things like starting their own businesses while no one was watching. But if remote productivity and collaboration won't work within the tech industry, others pointed out, what is the message for other industries? Was this a high-profile example of a tech company shooting itself in the foot?

Supporters of the change defended the move as a need for control in this particular company based on the constant directional changes at Yahoo, the low morale of employees, and the lack of face-time and collaboration needed to keep up with the innovations of rivals. *The New York Times* quoted one former Yahoo official as saying, "In the tech world it was such a bummer to say you worked for Yahoo." The situation had gotten that bad.

Mayer's turnaround strategy required employee *skin in the game*—getting employees into the office. The company responded to critics with one blanket statement about the change: "This isn't a broad industry view about working from home. This is about what is right for Yahoo, right now."

The previous situation was viewed by Mayer as cultural self-strangulation. With no one in the building, and a revolving CEO door, projects slowed or were completely abandoned. Meanwhile, Facebook and other rivals were surging ahead, rolling out innovations, grabbing advertisers, and cornering the social media market while Yahoo hesitated.

Mayer jumped in, revamping the recently acquired Flickr, which had seemingly abandoned a potential leadership role in photo-sharing to rival Instagram. With new hires and a total redesign and update of Flickr, the move was heralded by *Entrepreneur* as Mayer's smartest. In addition, the new CEO quickly replaced employee BlackBerrys with Android and iPhones, with corporate picking up the tab for monthly usage. With bodies now working on-site, and in an effort to create an atmosphere of meeting and collaboration, Mayer offered free food in the cafeteria and insisted on day-long Friday question/answer/planning meetings between senior executives and all employees.

Yahoo must make up time and get up to speed within the industry quickly. Rivals are not waiting and some new ones doubtlessly lurk in the shadows. While some criticize what they see as Mayer's infantilizing of employees and clamping down on others as she added an on-site nursery for her own child, others developed a wait and see attitude—not only within the walls of Yahoo, but nationwide, as companies weigh the future of remote workforce cultures.

QUESTIONS

1. Why do you think Marissa Mayer adopted a more centralized and bureaucratic approach by bringing all employees on-site to work at Yahoo?
2. Why do you think many employees resisted this change?
3. What do you think will be the full impact of having employees work on-site rather than at home?

CASE FOR ANALYSIS | Bachmeyer Foods, Inc.[97]

Bachmeyer Foods is a large distribution company with more than 5,000 employees and gross sales of more than $900 million (2017). The company purchases salty snack foods and liquor and distributes them to independent retail stores throughout the United States and Canada. Salty snack foods include corn chips, potato chips, cheese curls, tortilla chips, pretzels, and peanuts. The United States and Canada are divided into 22 regions, each with its own central warehouse, salespeople, finance department, and purchasing department. The company distributes national and local brands and packages some items under private labels. Competition in this industry is intense. The demand for liquor has been declining, and snack food competitors like Procter & Gamble and Frito-Lay have developed new

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products and low-carb options to gain market share from smaller companies like Bachmeyer.

The head office encourages each region to be autonomous because of local tastes and practices. In the north-eastern United States, for example, people consume a greater percentage of Canadian whiskey and American bourbon, whereas in the West they consume more light liquors, such as vodka, gin, and rum. Snack foods in the South-west are often seasoned to reflect Mexican tastes, and customers in the North-east buy a greater percentage of pretzels. Early in 2003, Bachmeyer began using a financial reporting system that compared sales, costs, and profits across company regions. Each region was a profit center, and top management was surprised to learn that profits varied widely. By 2006, the differences were so great that management decided some standardization was necessary. Managers believed highly profitable regions were sometimes using lower-quality items, even seconds, to boost profit margins. This practice could hurt Bachmeyer's image. Most regions were facing cut-throat price competition to hold market share. Triggered by price cuts by Eagle Snacks, national distributors such as Frito-Lay, Borden, Nabisco, Procter & Gamble (Pringles), and Kraft Foods (Planters Peanuts) were pushing to hold or increase market share by cutting prices and launching new products. Independent snack food distributors had a tougher and tougher time competing, and many were going out of business.

As these problems accumulated, Joe Qualley, president of Bachmeyer, decided to create a new position to monitor pricing and purchasing practices. Claire Clemmons was hired from the finance department of a competing organization. Her new title was director of pricing and purchasing, and she reported to the vice president of finance, Peter Washington. Washington gave Clemmons great latitude in organizing her job and encouraged her to establish whatever rules and procedures were necessary. She was also encouraged to gather information from each region. Each region was notified of her appointment by an official memo sent to the 22 regional directors. A copy of the memo was posted on each warehouse bulletin board. The announcement was also made in the company newspaper.

After three weeks on the job, Clemmons decided two problems needed her attention. Over the long term, Bachmeyer should make better use of information technology. Clemmons believed information technology could provide more information to headquarters for decision making. Top managers in the divisions were connected to headquarters by an intranet, but lower-level employees and salespeople were not connected. Only a few senior managers in about half the divisions used the system regularly.

In the short term, Clemmons decided fragmented pricing and purchasing decisions were a problem and these decisions should be standardized across regions. This strategy should be undertaken immediately. As a first step, she wanted the financial executive in each region to notify her of any change in local prices of more than three percent. She also decided that all new contracts for local purchases of more than $5,000 should be cleared through her office. (Approximately 60 percent of items distributed in the regions were purchased in large quantities and supplied from the home office. The other 40 percent were purchased and distributed within the region.) Clemmons believed the only way to standardize operations was for each region to notify the home office in advance of any change in prices or purchases. She discussed the proposed policy with Washington. He agreed, so they submitted a formal proposal to the president and board of directors, who approved the plan. The changes represented a complicated shift in policy procedures, and Bachmeyer was moving into peak holiday season, so Clemmons wanted to implement the new procedures right away. She decided to send an e-mail message followed by a fax to the financial and purchasing executives in each region notifying them of the new procedures. The change would be inserted in all policy and procedure manuals throughout Bachmeyer within four months.

Clemmons showed a draft of the message to Washington and invited his comments. Washington said the message was a good idea but wondered if it was sufficient. The regions handled hundreds of items and were accustomed to decentralized decision making. Washington suggested that Clemmons ought to visit the regions and discuss purchasing and pricing policies with the executives. Clemmons refused, saying that such trips would be expensive and time consuming. She had so many things to do at headquarters and said that the trips were impossible to schedule. Washington also suggested waiting to implement the procedures until after the annual company meeting in three months, when Clemmons could meet the regional directors personally. Clemmons said this would take too long because the procedures would then not take effect until after the peak sales season. She believed the procedures were needed now. The messages went out the next day.

During the next few days, e-mail replies came in from seven regions. The managers said they were in agreement and were happy to cooperate.

Eight weeks later, Clemmons had not received notices from any regions about local price or purchase changes. Other executives who had visited regional warehouses indicated to her that the regions were busy as usual. Regional executives seemed to be following usual procedures for that time of year. She telephoned one of the regional managers and discovered that he did not know who she was and had never heard of her position. Besides, he said, "we have enough to worry about reaching profit goals without additional procedures from headquarters." Clemmons was chagrined that her position and her suggested changes in procedure had no impact. She wondered whether field managers were disobedient or whether she should have used another communication strategy.

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QUESTIONS

1. What types of control did Clemmons appear to be using at Bachmeyer? What are her assumptions about her control over people in the plants?
2. Why do you think her communication attempt to change procedures received little response?
3. What advice would you give Clemmons about communicating future changes in purchasing procedures?

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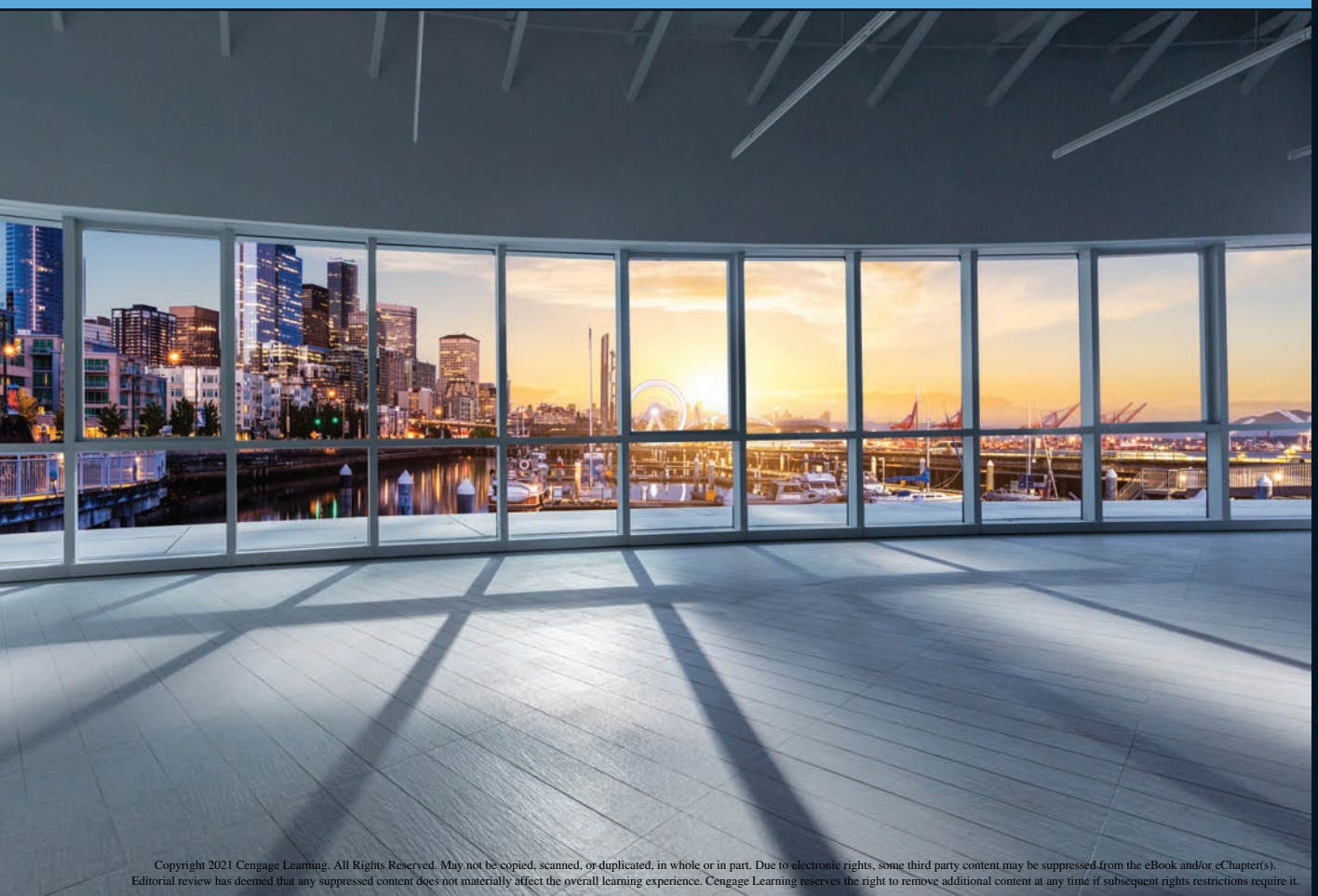
PART 5

Managing Dynamic Processes

Chapter 11 Organizational Culture and Control
Chapter 12 Innovation and Change
Chapter 13 Decision-Making Processes
Chapter 14 Conflict, Power, and Politics



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CHAPTER

11 Organizational Culture and Control

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Learning Objectives

After reading this chapter you should be able to:

1. Define organizational culture and identify symbols, rituals, stories, or other observable elements that signal cultural values in a company you are familiar with.
2. Describe the four types of organizational culture.
3. Explain the relationship between culture, corporate values, and performance.
4. Explain how managers create a high-performance culture.
5. Contrast a decentralized culture of control with a hierarchical culture of control.
6. Explain the feedback control model.
7. Describe the balanced scorecard's value for organizational control.

Chapter Outline

Organizational Culture

What Is Culture? • Emergence and Purpose of Culture • Interpreting/Shaping Culture

Culture and Organization Design

The Adaptability Culture • The Achievement Culture • The Clan Culture • The Bureaucratic Culture

Culture Strength and Organizational Subcultures

Culture and Performance

The Cultural Focus of Control Systems

The Changing Philosophy of Control • Feedback Control Model • Organization Level: The Balanced Scorecard • Department Level: Behavior Versus Outcome Control

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **Top managers typically should focus their energy more on strategy and structure than on corporate culture.**

I AGREE _____ **I DISAGREE** _____

2 **For a department manager, it should not matter much exactly how or when people get their work done, just as long as they produce good results.**

I AGREE _____ **I DISAGREE** _____

3 **For a high-level manager, emphasizing cultural values is more important than emphasizing performance metrics to achieve high performance.**

I AGREE _____ **I DISAGREE** _____

Amazon has grown into a huge, multinational corporation and owns more than 40 subsidiaries, including Zappos, Twitch, and Whole Foods Market. What makes Amazon distinctive is that it retains many elements of the startup culture embedded by its founder Jeff Bezos and other early leaders. Some former employees, or *escapees* as some call themselves, refer to Amazon's internal environment as a "gladiator culture" where a fierce competitiveness among employees seems embedded in everything. After the acquisition of Whole Foods Market, stories of employees literally crying on the job over changes Amazon was making began circulating. As one example, Whole Foods began using scorecards to measure how well people were complying with a new inventory control system, and the scores were being used to punish and sometimes fire workers. At Amazon, all aspects of performance are subject to constant measurement and review. Strict rules, aggressive goals, and surveillance keep behavior tightly controlled. Moreover, people are encouraged to report on their colleagues through various internal systems. Some people who have left Amazon say they wouldn't think of returning to work there. Others, however, love the pace and challenge of such a confrontational culture and find they can't work effectively anywhere else.[1]

Amazon is a highly successful company, and it has employees and managers who enjoy their jobs and generally like the way things are done at the company. It also has managers and employees who think the cultural values and ways of doing things are detrimental to employee happiness and long-term company success. Every organization, like Amazon, has particular values that characterize how people should behave and how the organization carries out everyday business. One of the most important jobs organizational leaders do is instill and support the kind of values needed for the company to thrive. Hiroshi Mikitani, co-founder and CEO of Rakuten, once said, "Leaders often treat culture as a happy accident—something that develops organically, driven by personalities. What a mistake. Culture is a critical building block of success."

Strong cultures can have a profound impact on a company, which can be either positive or negative for the organization. Google is known for its unique company culture that treats employees like gold and provides them with numerous perks in a laid-back, fun work environment. As co-founder Larry Page puts it, "it's important that the company be a family, that people feel that they're part of the company, and

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that the company is like a family to them. When you treat people that way, you get better productivity." Google is able to hire the best and brightest because people want to work there.[2] Negative cultural norms, however, can damage a company just as powerfully as positive ones can strengthen it. The culture at CBS has come under attack after more than two dozen women accused chairman and CEO Leslie Moonves, who was one of Hollywood's most celebrated entertainment executives for decades, of sexual misconduct. By the end of 2018, Moonves and two other high-ranking executives had lost their jobs. Managers at music trade publication *Billboard* are also working to build a more ethical culture after allegations of sexual harassment and management interference in editorial decisions came to light in a detailed article published by *The Daily Beast*. CEO John Amato left the company following an internal investigation, but current and former employees say the culture Amato instilled has led to routine incidents of harassment, inappropriate comments, and bullying by executives, as well as ongoing corporate meddling in editorial decisions.[3]

A related concept concerning the influence of norms and values on how people work together and how they treat one another and customers is called *social capital*. **Social capital** refers to the quality of interactions among people and whether they share a common perspective. In organizations with a high degree of social capital, relationships are based on trust, mutual understandings, and shared norms and values that enable people to cooperate and coordinate their activities to achieve goals.[4] An organization can have either a high or a low level of social capital. One way to think of social capital is as *goodwill*. When relationships both within the organization and with customers, suppliers, and partners are based on honesty, trust, and respect, a spirit of goodwill exists and people willingly cooperate to achieve mutual benefits. A high level of social capital enables frictionless social interactions and exchanges that help facilitate smooth organizational functioning. Relationships based on cutthroat competition, self-interest, and subterfuge can be devastating to a company.

Purpose of This Chapter

This chapter explores ideas about corporate culture and values, including those associated with organizational control. The first section describes the nature of corporate culture, its origins and purpose, and how to identify and interpret culture by looking at the organization's rites and ceremonies, stories and sayings, symbols, organization structures, power relationships, and control systems. We then examine how culture reinforces the strategy and structural design the organization needs to be effective in its environment and discuss how managers build a high-performance culture. Next, the chapter considers the cultural focus of organizational control systems, looking at the differences between hierarchical control and decentralized control. We describe the key steps in the feedback control model, discuss the balanced scorecard as a comprehensive control system, and look at the differences between behavior control and output control.

11.1 Organizational Culture

The popularity of the corporate culture topic raises a number of questions. Can we identify cultures? Can culture be aligned with strategy? How can cultures be managed or changed? The best place to start is by defining culture and explaining how it is reflected in organizations.

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11.1a What Is Culture?

Culture is the set of values, norms, guiding beliefs, and understandings that is shared by members of an organization and taught to new members as the correct way to think, feel, and behave.[5] It is the unwritten, feeling part of the organization. Culture represents the informal organization, whereas topics discussed in previous chapters, such as structure, size, strategy, and technology, represent the formal organization. Every organization has two sides at work: formal structures and systems and the informal values, norms, and assumptions of the corporate culture.[6] Everyone participates in culture, but culture generally goes unnoticed. It is only when managers try to implement new strategies, structures, or systems that go against basic cultural norms and values that they come face to face with the power of culture.

Organizational culture exists at two levels, as illustrated in Exhibit 11.1. On the surface are visible artifacts and observable behaviors—the ways people dress and act; office layouts; the type of control systems and power structures used by the company; and the symbols, stories, and ceremonies organization members share. The visible elements of culture, however, reflect deeper values in the minds of organization members. These underlying values, assumptions, beliefs, and thought processes operate unconsciously to define the culture.[7] For example, recall from the previous chapter's BookMark that leaders at TechCo don't have separate offices but sit in open bullpens with everyone else to encourage sharing of information. Another example comes from Germany's TeamBank, where top executives made the informal *Du* the mandatory form of address rather than the formal *Sie* commonly used in German workplaces. These are observable symbols. The underlying values are openness, collaboration, egalitarianism, and teamwork.[8] The attributes of culture display themselves in many ways but typically evolve into a patterned set of activities carried out through social interactions.[9] Those patterns can be used to interpret an organization's culture.

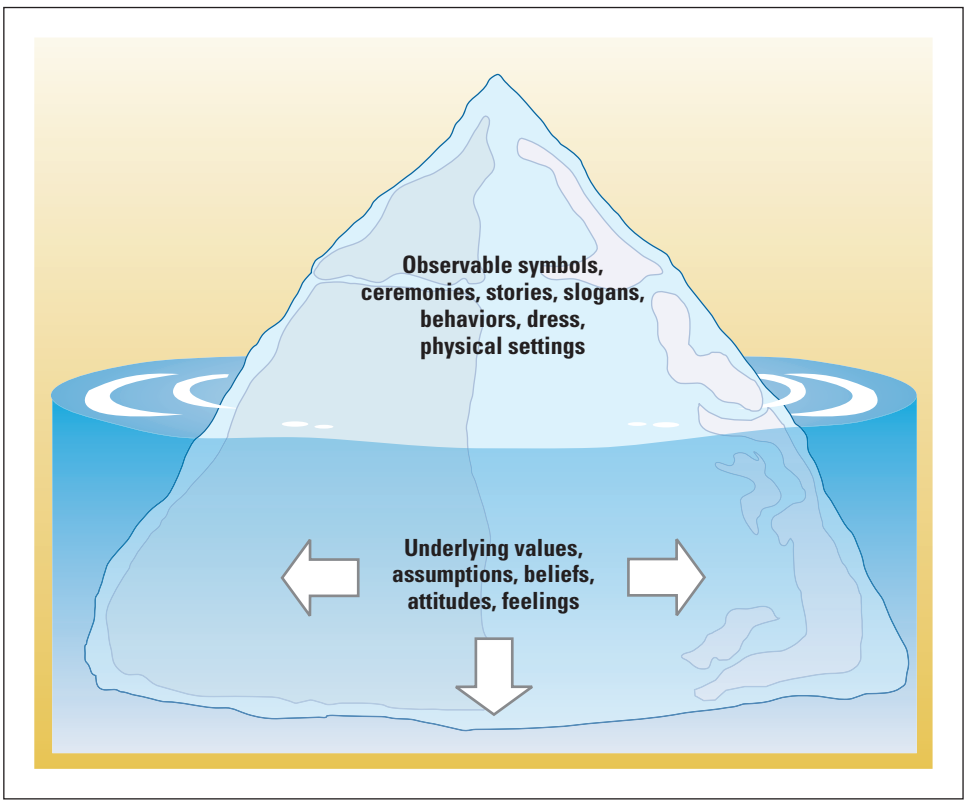

EXHIBIT 11.1
Levels of Corporate Culture

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11.1b Emergence and Purpose of Culture

Culture provides people with a sense of organizational identity and generates in them a commitment to beliefs and values that are larger than themselves.[10] Though ideas that become part of the culture can come from anywhere within the organization, an organization's culture generally begins with a founder or early leader who articulates and implements particular ideas and values as a vision, philosophy, or business strategy.

When these ideas and values lead to success, they become institutionalized, and an organizational culture emerges that reflects the vision and strategy of the founder or leader. For example, the culture at Amazon, described in the opening example, reflects the values of founder Jeff Bezos, who thrives on disagreement and challenge. Bezos believes leaders are responsible for challenging decisions or opinions when they disagree, even if it feels uncomfortable. Leaders have courage and stand by their convictions. They are tenacious and don't compromise for the sake of social cohesiveness. But once a decision is made, they commit to it wholeheartedly. Other values Bezos instilled in the Amazon culture include frugality, customer obsession, innovation, and a bias for action. When an employee asked at one of the early all-hands meetings when the company was going to create a better work–life balance for employees, Bezos bluntly told her that perhaps Amazon wasn't the company for her. "The reason we are here is to get stuff done, that is the top priority," Bezos said. "That is the DNA of Amazon."[11]

Cultures serve two critical functions in organizations: (1) to integrate members so that they know how to relate to one another and (2) to help the organization adapt to the external environment. **Internal integration** means that members develop a collective identity and understand how to work together effectively. It is culture that guides day-to-day working relationships and determines how people communicate within the organization, what behavior is acceptable or not acceptable, and how power and status are allocated. **External adaptation** refers to how the organization meets goals and deals with outsiders. Culture helps guide the daily activities of employees to meet certain goals. It can help the organization respond rapidly to customer needs or the moves of a competitor. Consider how the culture at Google fosters internal integration and helps the company adapt to the external environment.

IN PRACTICE
Google

Why has Google topped *Fortune*'s list of best places to work for six years in a row? The company is known for its fun perks, such as free food, nap pods, and ping pong tables. But those elements are a minuscule part of the culture that makes Google a great place to work and makes it so hard to get a job there. "If you took all that stuff away. . . you would still have the same company, the same drive for creativity and innovation," said Google's former Senior Vice President of People Relations.

People at Google are motivated by both the company's unofficial motto, "Don't be evil," and its formal mission, "to organize the world's information and make it universally accessible and useful." Google's founders created a clear list of core values when the company was only a few years old, including:

- Focus on the user and all else will follow
- It's best to do one thing really, really well
- You can be serious without a suit
- Great just isn't good enough

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Having a clear list of values has helped Google hire people who fit the culture and reinforce desired behaviors and attitudes, such as flexibility, collaboration, fun, and trust. Employees are encouraged to work when and how they like, to bring their pets to work if they want, and to learn from one another. Collaboration is so valued that managers encourage people to coach one another in the "Googler to Googler" program. This can include business skills such as public speaking as well as outside activities like kickboxing or dog training. Managers build and strengthen trust by being open and honest with employees at weekly Q&A sessions. At Google, failure is not punished but applauded as a way to learn and grow. Google is able to constantly innovate because employees feel free to experiment and fail, learning from their own and others' mistakes.[12]

An organization's culture also guides employee decision making in the absence of written rules or policies.[13] Thus, both functions of culture are related to building the organization's social capital by forging either positive or negative relationships both within the organization and with outsiders.

11.1c Interpreting/Shaping Culture

To identify and interpret culture requires that people make inferences based on observable artifacts. Artifacts can be used by leaders to shape culture, and they can also be studied to interpret culture. However, artifacts may be hard for outsiders to decipher accurately. An award ceremony in one company might have a different meaning than it does in another company. To understand what is really going on in an organization requires detective work and probably some experience as an insider. Exhibit 11.2 shows some aspects of the organization that can be observed to help decode the organizational culture.[14] At the same time, these aspects can be used or changed by managers to shape and influence culture. These aspects include rites and ceremonies, stories and sayings, symbols, organization structures, power relationships, and control systems.[15]

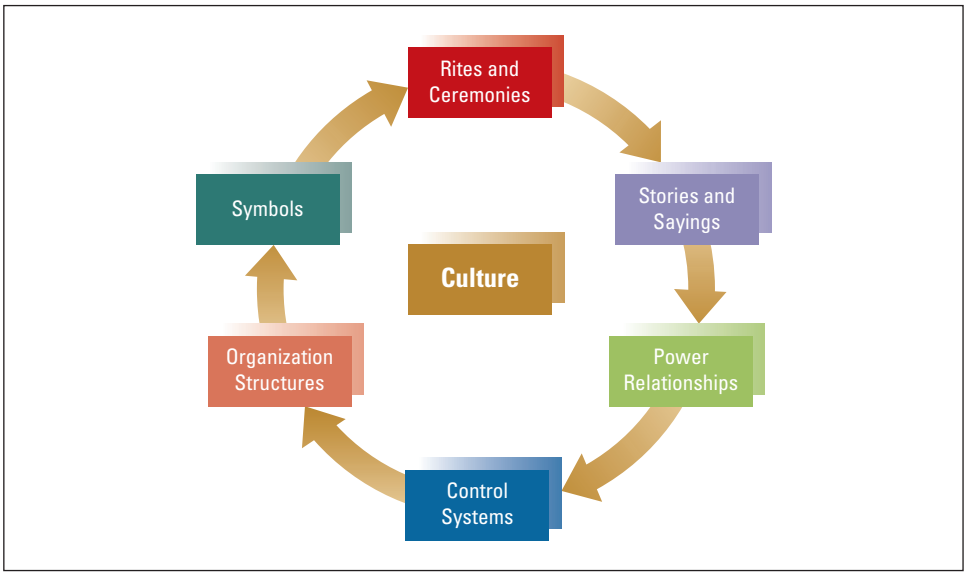

EXHIBIT 11.2
Observable Aspects of Organizational Culture

Sources: Based on Gerry Johnson, "Managing Strategic Change—Strategy, Culture, and Action," *Long Range Planning* 25, no. 1 (1992), 28–36, and Gerry Johnson, "Rethinking Incrementalism," *Strategic Management Journal* 9, no. 1 (1988), 75–91.

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Rites and Ceremonies. Cultural values can typically be identified in **rites and ceremonies**, the elaborate, planned activities that make up a special event and are often conducted for the benefit of an audience. Managers hold rites and ceremonies to provide dramatic examples of what a company values. These are special occasions that reinforce specific values, create a bond among people for sharing an important understanding, and anoint and celebrate heroes and heroines who symbolize important beliefs and activities.[16]

One type of rite that appears in organizations is a *rite of passage,* which facilitates the transition of employees into new social roles. Organizations as diverse as religious orders, sororities and fraternities, businesses, and the military use rites to initiate new members and communicate important values. Another type often used is a *rite of integration,* which creates common bonds and good feelings among employees and increases commitment to the organization. Consider the following examples:

- A rite of passage at Gentle Giant Moving Company, based in Somerville, Massachusetts, is the "stadium run." Founder and CEO Larry O'Toole decided to have new hires run the tiers of Harvard University stadium as a way to emphasize that people at the company work hard, challenge themselves, and go the distance rather than letting up if things get tough. After the run, O'Toole provides a hearty breakfast and gives an orientation speech. "You're not a Gentle Giant until you've done the run," said employee Kyle Green.[17]
- Pope Francis, leading an organization that has been rife with scandal, has used rites to capture attention and re-energize Catholics around the world. For example, to symbolize the values of humility and inclusivity, he modified a traditional ritual by washing the feet of prisoners at a youth detention center on Holy Thursday instead of washing the feet of priests, as his predecessors had done. The ritual also reportedly included two females and two Muslims for the first time. This might be considered a rite of integration.[18]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Pay attention to corporate culture. Understand the underlying values, assumptions, and beliefs on which culture is based as well as its observable manifestations. Evaluate corporate culture based on rites and ceremonies, stories and sayings, symbols, and the structures, control systems, and power relationships you can observe in the organization.

Stories and Sayings. **Stories** are narratives based on true events that are frequently shared among employees and told to new employees to inform them about an organization. Many stories are about company **heroes** who serve as models or ideals for upholding cultural norms and values. Some stories are considered **legends** because the events are historic and may have been embellished with fictional details.[19] Stories keep alive the primary values of the organization and provide a shared understanding among all employees. **Sayings** are mottoes or mantras that encapsulate key cultural values, such as Walmart's "Save Money, Live Better" or Google's "Don't be evil." Examples of how stories and sayings shape culture are as follows:

- At Brinker Capital, managers wanted a culture where people are held accountable, but CEO Noreen Beaman knew that sometimes people make mistakes, because she admits she made a big one early in her career. The point is to solve the problem and not make the same mistake again. One of the company's sayings is "Find it, fix it, prevent it." Lush Cosmetics uses the motto, "We reserve the right to make mistakes." Another firm uses the tag line, "Set Targets, Keep Score, Win" to emphasize values of competitiveness, risk-taking, and taking ownership for results.[20]
- Sometimes a saying grows out of a story, such as LEGO's "Only the best is good enough." As the story goes, back when the company was still making wooden toys, founder Ole Kirk's son Godtfred boasted that he had saved money by

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using just two coats of varnish rather than the usual three coats on a shipment of toy ducks going out that day. Ole was offended by the deception and made Godtfred go back to the train station, retrieve the shipment, and spend the night correcting his error. Godtfred, who worked for the company from the time he was 12 years old and later became its CEO, immortalized his father's ideal by carving the motto into a wooden plaque. A photo of it now hangs over the entrance to the cafeteria at LEGO headquarters in Billund, Denmark.[21]

Symbols. Another tool for interpreting culture is the **symbol**. A symbol is something that represents another thing. In one sense, ceremonies, stories, sayings, and rites are all symbols because they symbolize deeper values. Another symbol is a physical artifact of the organization. Physical symbols are powerful because they focus attention on a specific item. Examples of physical symbols are as follows:

- In the conference rooms at Amazon headquarters, the conference tables are composed of half a dozen door-desks pushed together side by side. Frugality is one of the core values at Amazon, and founder Jeff Bezos says the door desk is "a symbol of spending money on things that matter to customers and not spending money on things that don't." Bezos built his first desk out of a door with four-by-fours as legs and reportedly still uses a door desk today, as do most employees at Amazon. The company gives "Door-Desk awards" to employees who come up with ideas that help deliver lower prices to customers.[22]
- When Mike Hyatt took over as CEO of Thomas Nelson Publishers, one of his first acts to change the culture from hierarchical to more egalitarian was to change the boardroom conference table. The boardroom was seldom used and had a long, narrow rectangular-shaped table that signaled hierarchy with the most important person sitting at the head of the table. Hyatt replaced that long table with a large circular table, signaling a new egalitarian culture. Hyatt also changed the boardroom to a conference room that was used often for employee meetings. Whenever Hyatt attended a meeting in the room, he sat in a different location to signal equality with other employees at the meeting.[23]

Organization Structures. How the organization is designed is also a reflection of its culture. Does it have a rigid *mechanistic* structure or a flexible *organic* structure, as described in Chapters 1 and 4? Is there a tall or a flat hierarchy, as discussed in Chapter 3? The way in which people and departments are arranged into a whole, and the degree of flexibility and autonomy people have, tells a lot about which cultural values are emphasized in the organization. Here are a couple of examples:

- Nordstrom's structure reflects the emphasis the department store chain puts on empowering and supporting lower-level employees. Nordstrom is known for its extraordinary customer service. Its organization chart, shown in Exhibit 11.3, symbolizes that managers are to support the employees who give the service rather than exercise tight control over them.[24]
- To get a struggling Chrysler back on its feet quickly after bankruptcy reorganization, its former CEO, the recently deceased Sergio Marchionne, cut several layers of management to flatten the structure and get top executives closer to the business of making and selling vehicles. Marchionne also chose a fourth-floor office in the technical center, rather than occupy the top-floor executive suite, to symbolize the importance of top executives being close to the engineers and supervisors making day-to-day decisions.[25]

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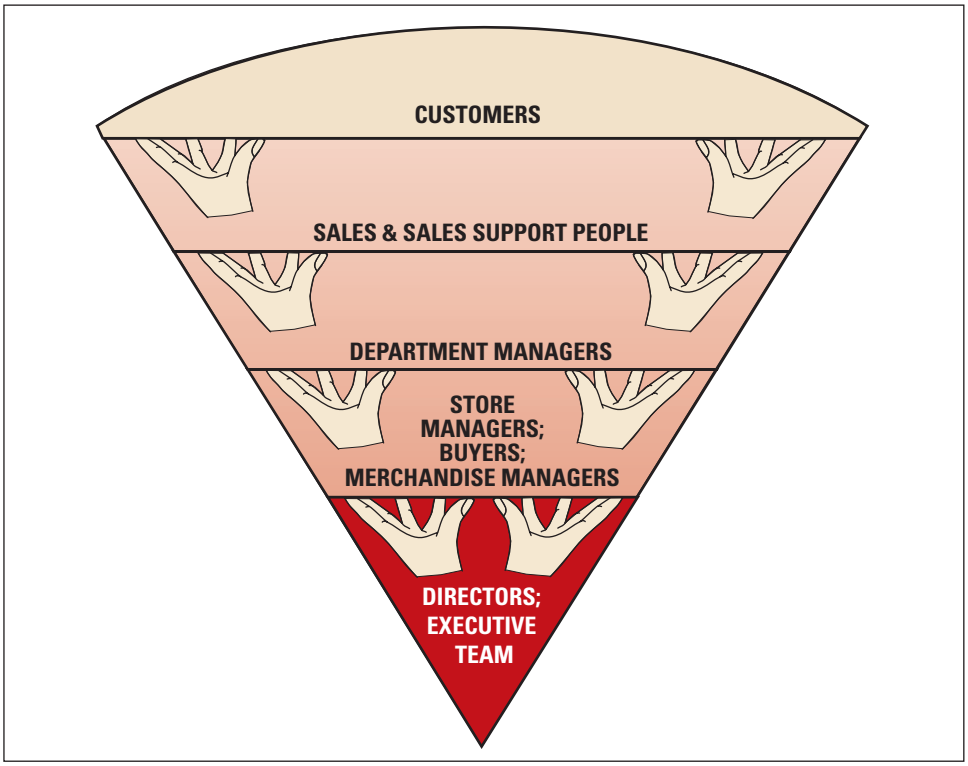
EXHIBIT 11.3
Organization Chart for Nordstrom Inc.



Source: Used with permission of Nordstrom, Inc.

Power Relationships. Looking at power relationships means deciphering who influences or manipulates or has the ability to do so. Which people and departments are the key power holders in the organization? In some companies, finance people are quite powerful, whereas in others engineers and designers have the most power. Another aspect is considering whether power relationships are formal or informal, such as whether people have power based primarily on their position in the hierarchy or based on other factors, such as their expertise or admirable character. Consider the following examples:

- An investment firm in Atlanta, Georgia, has an "inner sanctum" with special offices, restrooms, and a dining room for senior executives. The entry door has an electronic lock that only members can access. Mid-level managers hold the title of "director" and eat in a separate dining room. First-level supervisors and other employees share a general cafeteria. Dining facilities and titles signal who has more power in the vertical hierarchy of the organization.
- At W. L. Gore, few people have titles, and no one has a boss. Rather than people having power based on their position, leaders emerge based on who has a good idea and can recruit people to work on it.[26]

Control Systems. The final element shown in Exhibit 11.2 relates to control systems or the inner workings of how the organization controls people and operations. This includes such things as how information is managed, quality control systems, methods of financial control, reward systems, how decisions are made, and whether managers apply behavior or outcome control related to employee activities. Behavior versus outcome control and other aspects of controlling the organization will be

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discussed in detail later in this chapter. Two examples of how control systems reflect culture are as follows:

- At Anheuser-Busch InBev, distribution center managers frequently start the day with a sort of pep rally reviewing the day's sales targets and motivating people to get out and sell more beer. The company's incentive-based compensation system and its focus on increasing sales while relentlessly cutting costs are key elements of a highly competitive corporate culture.[27]
- Facing regulatory and legal problems related to multibillion-dollar losses from the "London Whale" investment fiasco and other issues, JPMorgan Chase CEO Jamie Dimon said, "Fixing our control issues is job No. 1." Dimon shifted the reporting lines so that Morgan's top compliance officer reports directly to the bank's chief operating officer, not to the general counsel. In addition to giving compliance and risk managers more stand-alone authority, Dimon added thousands more staff members to work on legal and regulatory matters. These changes symbolize that Morgan is as dedicated to maintaining control as it is to recording profits, Dimon says.[28]

Recall that culture exists at two levels—the underlying values and assumptions and the visible artifacts and observable behaviors. The rites and ceremonies, stories and sayings, symbols, organization structures, power relationships, and control systems just described are visible manifestations of underlying company values. These visible artifacts and behaviors can be used to interpret culture, and they are also used by managers to shape company values and to strengthen the desired corporate culture. Thus, the summary of cultural artifacts shown in Exhibit 11.2 can serve as both a mechanism for interpretation and a guideline for action when managers need to change or strengthen cultural values.[29]

REMEMBER THIS

- Cultural values help determine the organization's social capital, and the right values can contribute to organizational success.
- Culture is the set of key values, beliefs, and norms shared by members of an organization.
- Organizational cultures serve two critically important functions—to integrate members so that they know how to relate to one another and to help the organization adapt to the external environment.
- Culture can be both interpreted by and shaped by the organization's rites and ceremonies, stories and sayings, symbols, structures, control systems, and power relationships. Managers can also use these elements to change the organization's culture.

11.2 Culture and Organization Design

Managers want a corporate culture that reinforces the strategy and structural design that the organization needs to be effective within its environment. For example, if the external environment requires flexibility and responsiveness, such as the environment for Internet-based companies like Twitter, Facebook, Pinterest, or Netflix, the culture should encourage adaptability. The correct relationship among cultural values, organizational strategy and structure, and the environment can enhance organizational performance.[30]

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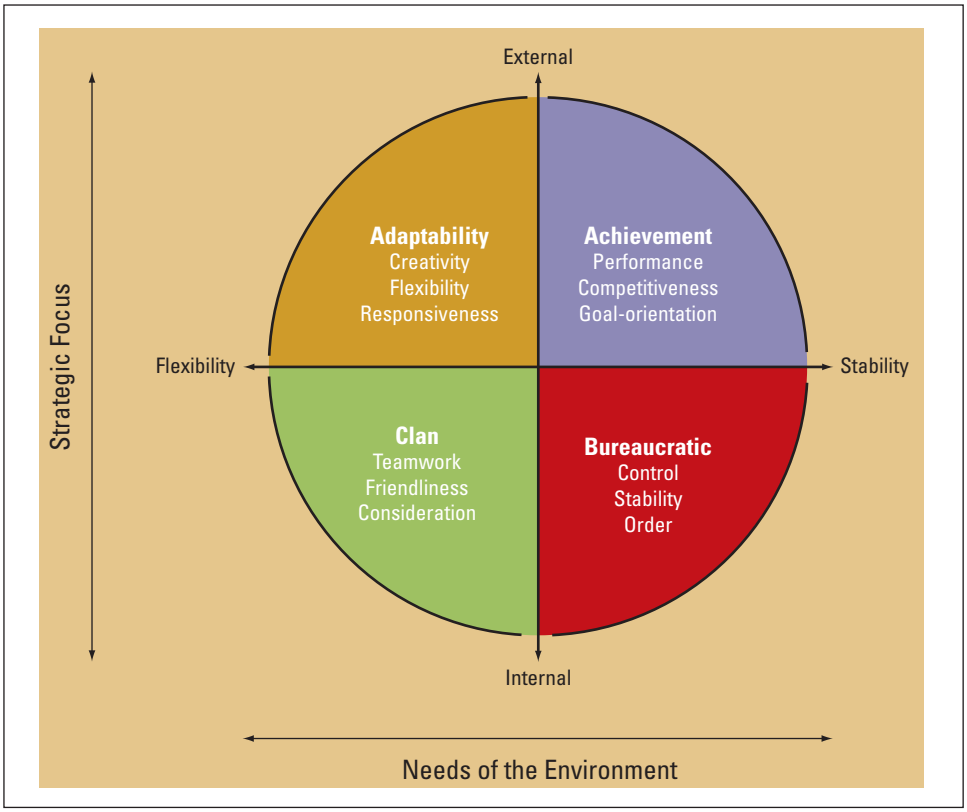
Cultures can be assessed along many dimensions, such as the extent of collaboration versus isolation among people and departments, the importance of control and where control is concentrated, or whether the organization's time orientation is short range or long range.[31] Here, we focus on two specific dimensions: (1) the extent to which the competitive environment requires flexibility or stability and (2) the extent to which the organization's strategic focus and strength are internal or external. Four categories of culture associated with these differences, as illustrated in Exhibit 11.4, are adaptability, achievement, clan, and bureaucratic.[32] These four categories relate to the fit among cultural values, strategy, structure, and the environment. Each can be successful, depending on the needs of the external environment and the organization's strategic focus.

ASSESS YOUR ANSWER

1 Top managers typically should focus their energy more on strategy and structure than on corporate culture.

ANSWER: *Disagree.* Smart top managers know that for the organization to be successful, the right culture has to support and reinforce the strategy and structure to be effective in its environment. Someone once said, "Culture eats strategy for lunch." Managers can invest all the time and resources they have in defining a killer strategy but implementing it will be impossible if the cultural values are out of line.

EXHIBIT 11.4
Four Types of Organizational Culture



Sources: Based on Daniel R. Denison and Aneil K. Mishra, "Toward a Theory of Organizational Culture and Effectiveness," *Organization Science* 6, no. 2 (March–April 1995), 204–223; Robert E. Quinn, *Beyond Rational Management: Mastering the Paradoxes and Competing Demands of High Performance* (San Francisco: Jossey-Bass, 1988); and Mohamed Hafar, Wafi Al-Karaghouli, and Ahmad Ghoneim, "An Empirical Investigation of the Influence of Organizational Culture on Individual Readiness for Change in Syrian Manufacturing Organizations," *Journal of Organizational Change Management* 27, no. 1 (2014), 5–22.

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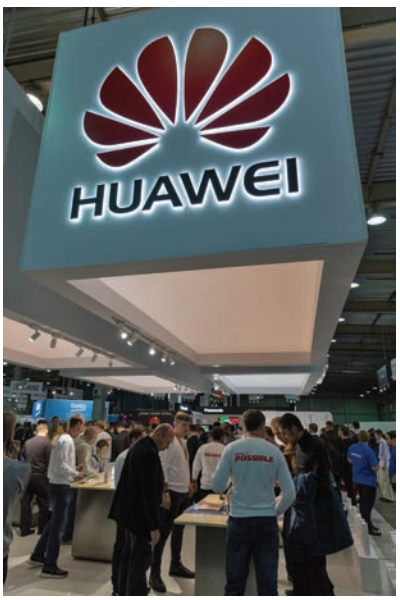
11.2a The Adaptability Culture

The **adaptability culture** is characterized by strategic focus on the external environment through flexibility and change to meet customer needs. The culture encourages entrepreneurial values, norms, and beliefs that support the capacity of the organization to detect, interpret, and translate signals from the environment into new behavior responses. This type of company, however, doesn't just react quickly to environmental changes—it actively creates change. Innovation, creativity, and risk taking are valued and rewarded.

Most Internet-based companies, such as Google, described in the previous In Practice, use the adaptability type of culture, as do many companies in the marketing, electronics, and cosmetics industries, because they must move quickly to satisfy customers.

11.2b The Achievement Culture

An organization concerned with serving specific customers in the external environment, but without the need for rapid change, is suited to the achievement culture. The **achievement culture** is characterized by emphasis on a clear vision of the organization's purpose and on the achievement of goals, such as sales growth, profitability, or market share, to help accomplish the purpose. Individual employees may be responsible for a specified level of performance, and the organization promises specified rewards in return. Managers shape behavior by envisioning and communicating a desired future state for the organization. Because the environment is stable, they can translate the vision into measurable goals and evaluate employee performance for meeting them. In some cases, achievement cultures reflect a high level of competitiveness and a profit-making orientation. Amazon, described in the opening example, reflects aspects of an achievement culture with its emphasis on competitiveness, assertiveness, and achieving growing sales and market share. Chinese technology company Huawei illustrates a radical version of the achievement culture.



Sergiy Palamarchuk/Shutterstock.com

IN PRACTICE
Huawei

They call it the "wolf culture." Company stories celebrate heroes such as the employees who worked to keep telecommunication services running despite a terrorist attack in Mumbai and those who battled freezing cold, low oxygen levels, and sleeplessness to provide mobile phone service to climbers on Mount Everest. Tenacity, drive, determination, and aggressiveness are core values at Huawei, the giant Chinese telecommunications and consumer electronics company that has rapidly expanded around the world.

Employees are encouraged to work grueling hours, to persevere under dangerous conditions to gain new business, and even to bend company rules as long as doing so enriches the company and not the employee personally. New employees undergo boot camp-style training that includes morning jogs, classes on the company's culture, and writing and performing skits that illustrate how they would persevere to serve customers in war zones or other challenging conditions.

(Continued)

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This hard-charging culture has helped Huawei grow, but it has also gotten it into trouble. Workers have been accused of bribing government officials, copying a competitor's source code, and committing bank fraud, among other misdeeds. Huawei previously evaluated employees solely according to how much business they won. Founder and CEO Ren Zhengfei said Huawei is now paying more attention to internal rules and controls to prevent employee misconduct, but in an e-mail to employees, he made it clear that enforcing rules and standards shouldn't become a hindrance: "If it blocks the business from producing grain, then we all starve to death," Ren said.[33]

Another company that reflects an achievement culture is Anheuser-Busch InBev, mentioned earlier in the chapter. Managers keep employees focused on achieving high sales and profit levels, and those who meet the demanding goals are handsomely rewarded. Bonuses and promotions at Anheuser-Busch InBev are based on performance, not seniority, and top executives are unapologetic about giving special treatment to high achievers.[34]

11.2c The Clan Culture

The **clan culture** has a primary focus on the involvement and participation of the organization's members and on rapidly changing expectations from the external environment. This culture is similar to the clan form of control described in Chapter 10. More than any other, this culture focuses on meeting the needs of employees as the route to high performance. Involvement and participation create a sense of responsibility and ownership and, hence, greater commitment to the organization.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Make sure corporate culture is consistent with strategy and the environment. Use aspects of an adaptability culture, achievement culture, clan culture, or bureaucratic culture depending on the needs of the external environment and the organization's strategic focus.

In a clan culture, an important value is taking care of employees and making sure they have whatever they need to help them be satisfied as well as productive. Southwest Airlines, which ranked No. 1 on *Workforce* magazine's 2019 list of the top 100 companies that excel in people management, illustrates a clan culture. "We've really put our employees first since the beginning . . .," said Julie Weber, vice president and chief people officer. "Our belief is that happy employees make for happy customers, which make for happy shareholders."[35] The approach to culture taken by Marc Benioff at software company Salesforce .com also reflects elements of a clan culture. "I want a company where people are excited to come to work every day, where they feel good when they get here, where it doesn't take from them but it's giving to them, it's giving to others," Benioff says. On an employee's first day at Salesforce, the morning is spent showing the new hire around the offices and introducing colleagues."Then we take them out and they do service in the afternoon," says Benioff. "They'll go to a homeless shelter or they'll go to the hospital or go to a public school. This is a very core part of our culture."[36]

11.2d The Bureaucratic Culture

The **bureaucratic culture** has an internal focus and a consistency orientation for a stable environment. This type of culture supports a methodical approach to doing business. Symbols, heroes, and ceremonies reinforce the values of cooperation,

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tradition, and following established policies and practices as ways to achieve goals. Personal involvement is somewhat lower here, but that is outweighed by a high level of consistency, conformity, and collaboration among members. This organization succeeds by being highly integrated and efficient.

Today, most managers are shifting away from bureaucratic cultures because of a need for greater flexibility. However, SAS Institute and Pacific Edge Software (now part of Serena Software) have successfully used some elements of a bureaucratic culture to keep projects on time and on budget and to ensure saner lives for employees. Emphasis on order and discipline means the formal workweek at SAS is 35 hours, for instance. Although sometimes being careful means being slow, Pacific Edge and SAS have managed to keep pace with the demands of the external environment.[37]

Some people like the order and predictability of a bureaucratic culture, whereas other people would feel stifled and constrained by too much discipline and would be happier working in some other type of culture. Complete the questionnaire in the "How Do You Fit the Design?" box to get an idea of which type of culture—adaptability, achievement, clan, or bureaucratic—you would be most comfortable and successful working in.

REMEMBER THIS

- Organizational culture should reinforce the strategy and structure that the organization needs to be successful in its environment.
- Four types of culture that may exist in organizations are adaptability culture, achievement culture, clan culture, and bureaucratic culture.

HOW DO YOU FIT THE DESIGN?

CORPORATE CULTURE PREFERENCE

The fit between a manager or employee and corporate culture can determine both personal success and satisfaction. To understand your culture preference, rank the following items from 1 to 8 based on the strength of your preference (1 = highest preference; 8 = lowest preference).

1. The organization is very personal, much like an extended family. _____
2. The organization is dynamic and changing, where people take risks. _____
3. The organization is achievement-oriented, with the focus on competition and getting jobs done. _____
4. The organization is stable and structured, with clarity and established procedures. _____
5. Management style is characterized by teamwork and participation. _____
6. Management style is characterized by innovation and risk-taking. _____
7. Management style is characterized by high-performance demands and achievement. _____
8. Management style is characterized by security and predictability. _____

(continued)

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Scoring: To compute your preference for each type of culture, add together the scores for each set of two questions as follows:

Clan culture—total for questions 1, 5:_____
Adaptability culture—total for questions 2, 6:_____
Achievement culture—total for questions 3, 7:_____
Bureaucratic culture—total for questions 4, 8:_____

Interpretation: Each of the preceding questions pertains to one of the four types of culture in Exhibit 11.4. A lower score means a stronger preference for that specific culture. You will likely be more comfortable and more effective as a manager in a corporate culture that is compatible with your personal preferences. A higher score means the culture would not fit your expectations, and you would have to change your style to be effective. Review the text discussion of the four culture types. Do your cultural preference scores seem correct to you? Can you think of companies that would fit your culture preference?

Source: Adapted from Kim S. Cameron and Robert E. Quinn, *Diagnosing and Changing Organizational Culture* (Reading, MA: Addison-Wesley, 1999).

11.3 Culture Strength and Organizational Subcultures

Culture strength refers to the degree of agreement among members of an organization about the importance of specific values. If widespread consensus exists about the importance of those values, the culture is cohesive and strong; if little agreement exists, the culture is weak.[38] A strong culture reflects clear values and social norms—that is, people know what is expected. There is generally little differentiation among people within the culture and a low tolerance for deviation from the norm. Resistance to change is strong because people like the culture and want to keep things as they are.[39]

A strong culture is typically associated with the frequent use of ceremonies, symbols, and stories and sayings that express key values, as described earlier, and managers align structures and processes to support the cultural values. These elements increase employee commitment to the values and strategy of a company. However, culture is not always uniform throughout the organization, particularly in large companies. Even in organizations that have strong cultures, there may be several sets of subcultures. **Subcultures** develop to reflect the common problems, goals, and experiences that members of a team, department, or other unit share. An office, branch, or unit of a company that is physically separated from the company's main operations may also take on a distinctive subculture.

For example, although the dominant culture of an organization may be an achievement culture, various departments may also reflect characteristics of adaptability, clan, or bureaucratic cultures. The manufacturing department of a large organization may thrive in an environment that emphasizes order, efficiency, and obedience to rules, whereas the research and development (R&D) department may be characterized by employee empowerment, flexibility, and customer focus. This is similar to the concept of differentiation described in Chapter 4, where employees in manufacturing, sales, and research departments studied by Paul Lawrence and Jay Lorsch[40] developed different values with respect to time horizon, interpersonal relationships, and formality in order to perform the job of each particular department most effectively. Consider how the credit division of Pitney Bowes, a global technology company most known for its postage meters, copiers, and other office equipment, developed a distinctive subculture to encourage innovation and risk-taking.

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IN PRACTICE

Pitney Bowes Credit Corporation

Pitney Bowes, a maker of postage meters and other office equipment, has long thrived in an environment of order and predictability. Its headquarters reflects a typical corporate environment and an orderly culture with its blank walls and bland carpeting. But step onto the third floor of the Pitney Bowes building in Shelton, Connecticut, and you might think you're at a different company. The domain of Pitney Bowes Credit Corporation (PBCC) looks more like an indoor theme park, featuring cobblestone-patterned carpets, faux gas lamps, and an ornate town square-style clock. It also has a French-style café, a 1950s-style diner, and the "Cranial Kitchen," where employees sit in cozy booths to surf the Internet or watch training videos. The friendly hallways encourage impromptu conversations, where people can exchange information and share ideas they wouldn't otherwise share.

PBCC traditionally helped customers finance their business with the parent company. However, PBCC's president and CEO worked with other managers to redefine the division as a *creator* of services rather than just a provider of services. Rather than just financing sales and leasing of existing products, PBCC now creates new services for customers to buy. For example, Purchase Power is a revolving line of credit that helps companies finance their postage costs. It was profitable within nine months and quickly signed up more than 400,000 customers. When PBCC redefined its job, it began redefining its subculture to match by emphasizing values of teamwork, risk taking, and creativity. "We wanted a fun space that would embody our culture," said the CEO. "No straight lines, no linear thinking. Because we're a financial services company, our biggest advantage is the quality of our ideas." So far, PBCC's new approach is working. In one year, the division, whose 600 employees make up less than two percent of Pitney Bowes' total workforce, generated 36 percent of the company's net profits.[41]

Subcultures typically include the basic values of the dominant organizational culture plus additional values unique to members of the subculture. However, subcultural differences can sometimes lead to conflicts between departments or divisions, especially in organizations that do not have strong overall corporate cultures. When subcultural values become too strong and outweigh the corporate cultural values, conflicts may emerge and hurt organizational performance. Conflict will be discussed in detail in Chapter 14. Cultural conflicts can be particularly challenging in the case of mergers and acquisitions. Studies by consulting firms such as Hay Group and McKinsey & Company suggest that performance declines in about 20 percent of acquired companies after acquisition. Some experts estimate that 90 percent of mergers never live up to expectations.[42] One reason is the difficulty of integrating the separate corporate cultures. For example, after Facebook bought the popular messaging service WhatsApp, disagreements emerged as WhatsApp leaders' and staff members' strong cultural belief in protecting user privacy came into conflict with Facebook's broad data-gathering about user activities. WhatsApp's founders eventually left the company, and it remains to be seen if Facebook can effectively blend the Facebook and WhatsApp cultures.[43] The BookMark further examines the idea of cultural conflicts.

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REMEMBER THIS

- When widespread consensus exists about the importance of specific values, the organizational culture is strong and cohesive.
- Even in organizations with strong cultures, several sets of subcultures may emerge, particularly in large organizations.
- After a merger or acquisition, one of top managers' toughest jobs is often that of integrating different corporate cultures.

BOOKMARK 11.0 HAVE YOU READ THIS BOOK?

Rule Makers, Rule Breakers: How Tight and Loose Cultures Wire Our World

By Michele Gelfand

Psychologist Michele Gelfand says it is culture (ideals, beliefs, and symbols) rather than more tangible, material things such as money, circumstances, and opportunity that ultimately drives human behavior. In *Rule Makers, Rule Breakers,* Gelfand draws attention to one aspect of culture she believes has been ignored—social norms, the rules, the dos and don'ts that come about whenever people come together. Social norms are the glue that holds groups together. They help people cooperate, adapt, and survive but they can also be the source of much conflict.

From studies of around 7,000 people in over 30 countries Gelfand developed a tightness-looseness system for classifying cultures. The degree of strictness of rules determines where a culture falls on a continuum from *tight* to *loose*. "Tight cultures have strong social norms and little tolerance for deviance, while loose cultures have weak social norms and are highly permissive," she states. Gelfand notes that tight cultures tend to form when there is a perception of threat; the greater the sense of threat, the tighter the rules and norms and vice versa. These norms and the interaction between tight and loose, between the rule makers and the rule breakers, affect nations, social classes, family and friendship circles, and even the happiness of individuals. They also influence organizations and can be particularly bothersome in the case of mergers and acquisitions.

WHAT HAPPENS WHEN CULTURES CLASH

Here are some examples of what happens when cultures collide after a merger:

- ***Will the Cultures Get Along?*** "When tight and loose cultures merge, there is a good chance that they will clash." In looking at more than 6,000 mergers and acquisitions between 1980 and 2013, Gelfand and her colleagues discovered that more than half of all mergers destroy shareholder value."In fact," Gelfand writes, "when there was a pronounced cultural mismatch, the acquiring company lost [US] $30 million on average within five days of the merger's announcement."
- ***The Marriage Made in Heaven Goes to Divorce Court.*** Gelfand points to the 1988 merger of Germany's Daimler and U.S.-based Chrysler. Daimler leaned heavily toward the tight side of the social norms scale, with its emphasis on precision and consistency and top-down management while Chrysler leaned toward the loose with "a more relaxed, freewheeling, and egalitarian business culture." With such a disparity in social norms, what was billed as a marriage made in Heaven led to key executives leaving, steep losses for investors, and in 2007, the divorce—Daimler's sale of Chrysler to private equity firm Cerberus Capital, at a loss of billions of dollars.

LOOSE OR TIGHT—WHICH IS RIGHT?

Gelfand says the answer lies in the Goldilocks Principle—somewhere between too hot and too cold, too tight and too loose, is just right. To reach the right balance to survive and prosper, companies should become culturally ambidextrous, incorporating features from the other end of the spectrum. Tight companies should work toward a "flexible tightness" and loose companies toward a "structured looseness." When considering a merger, managers should always consider cultural compatibility and promote a culture in which cohesion and diversity can coexist, but Gelfand admits, "It's not easy, no matter how minor the change."

Rule Makers, Rule Breakers: How Tight and Loose Cultures Wire Our World, by Michele Gelfand, is published by Scribner.

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11.4 Culture and Performance

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Pay attention to both cultural values and business results to build a high-performance culture. Consciously manage culture to shift values toward high performance and goal accomplishment.

One of the most important things managers do is shape organizational culture to meet strategic goals because culture has a significant impact on performance. In *Corporate Culture and Performance,* John Kotter and James Heskett provided evidence that companies that intentionally managed cultural values outperformed similar companies that did not. Other research validates that elements of corporate culture are positively correlated with higher financial performance.[44] A strong culture that encourages responsiveness and change enhances organizational performance by energizing and motivating employees, unifying people around shared goals and a higher mission, and shaping and guiding behavior so that everyone's actions are aligned with strategic priorities. The right culture can drive high performance.

Successful companies are those in which managers are evaluated and rewarded for paying careful attention to both cultural values *and* business performance. Exhibit 11.5 illustrates four organizational outcomes based on the relative attention that managers pay to cultural values and business results.[45] For example, managers in Quadrant C pay little attention to either values or business results and the company is unlikely to survive for long. Managers in Quadrant D are highly focused on creating a strong cohesive culture, but they don't tie organizational values directly to strategic goals and desired business results.

When cultural values aren't connected to business performance, they aren't likely to benefit the organization during hard times. For example, the corporate culture at the LEGO Group nearly doomed the toymaker in the 1990s when sales plummeted as children turned from traditional toys to video games. At that time, LEGO reflected the characteristics found in Quadrant D of Exhibit 11.5. Imagination and

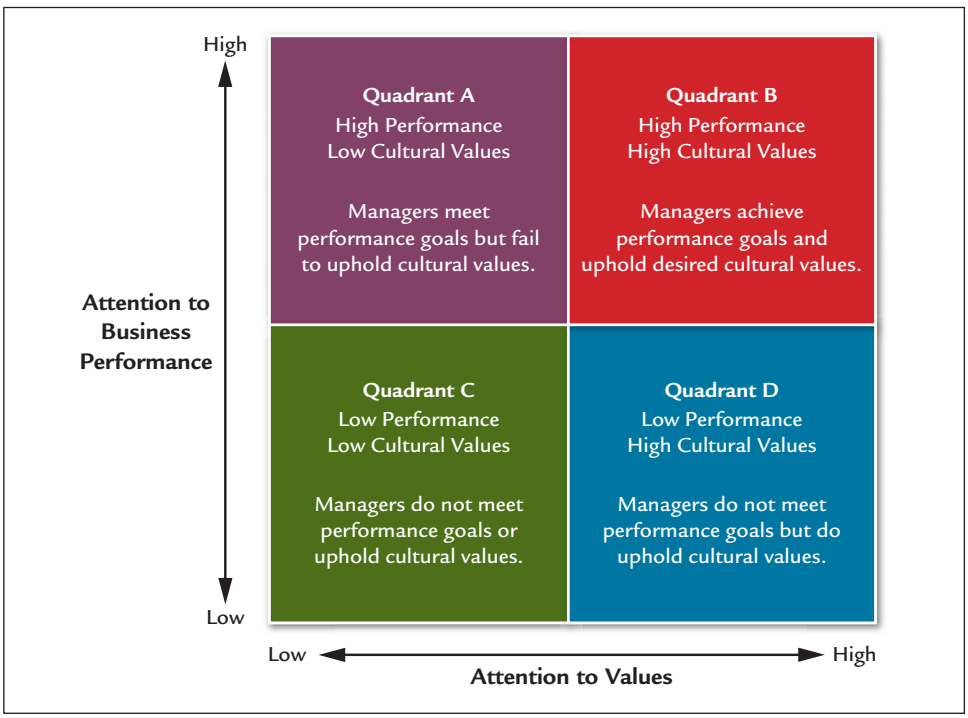

EXHIBIT 11.5
Combining Culture and Performance

Sources: Adapted from Jeff Rosenthal and Mary Ann Masarech, "High-Performance Cultures: How Values Can Drive Business Results," *Journal of Organizational Excellence* (Spring 2003), 3–18; and Dave Ulrich, Steve Kerr, and Ron Ashkenas, Figure 11-2, GE Leadership Decision Matrix, *The GE Work-Out: How to Implement GE's Revolutionary Method for Busting Bureaucracy and Attacking Organizational Problems—Fast!* (New York: McGraw-Hill, 2002), 230.

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creativity, not business performance, were what guided the company. The attitude among managers was, "We're doing great stuff for kids—don't bother us with financial goals." When he became CEO in 2004, Jørgen Vig Knudstorp upended the corporate culture with a new employee motto: "I am here to make money for the company." The shift had a profound impact, and LEGO has become one of the most successful companies in the toy industry.[46]

Quadrant A represents managers who are focused primarily on bottom-line results and pay little attention to organizational values. This approach may be profitable in the short run, but the success is difficult to sustain over the long term because the "glue" that holds the organization together—that is, shared cultural values—is missing. Indeed, a leader driven only by performance can create a toxic culture. As we have discussed in previous chapters, former Uber CEO Travis Kalanick built the ride-hailing firm into one of the world's most valuable startups, but his

ASSESS YOUR ANSWER

2 For a high-level manager, emphasizing cultural values is more important than emphasizing performance metrics to achieve high performance.

ANSWER: *Disagree.* An emphasis on positive cultural values is important, but managers must also pay strong attention to performance metrics for the organization to be successful. Achieving high performance requires attention to both values and solid business performance.

focus on rapid growth and lack of attention to positive cultural values damaged the company's reputation and threatened its continued expansion. Kalanick was forced out and the board of directors began working with new leaders to overhaul the culture. Director Arianna Huffington said, "Creating a great culture will be the key to future success and, going forward, there can be no room at Uber for brilliant jerks and zero tolerance for anything but totally respectful behavior."[47]

Finally, managers in Quadrant B put high emphasis on both culture and solid business performance as drivers of organizational success. Managers in these organizations align values with the company's day-to-day operations—hiring practices, performance management, budgeting, criteria for promotions and rewards, and so forth. Consider the approach that GE took to accountability and performance management under the leadership of Jack Welch. Welch helped GE become one of the world's most successful and admired companies by creating a culture in which risk was rewarded and accountability and measurable goals were keys to individual success and company profitability.[48] The company's traditional approach had achieved stellar financial results, but managers motivated people to perform primarily through control, intimidation, and reliance on a small circle of staff. Welch was interested in more than just financial results—he wanted managers to exhibit the following cultural values in addition to "making their numbers":[49]

- Have a passion for excellence and hate bureaucracy
- Be open to ideas from anywhere
- "Live" quality, and drive cost and speed for competitive advantage

Welch knew that for the company to succeed in a rapidly changing world, managers needed to pay careful attention to both cultural values and business performance. Quadrant B organizations represent the **high-performance culture**, a culture that (1) is based on a solid organizational mission or purpose,

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(2) embodies shared adaptive values that guide decisions and business practices, and (3) encourages individual employee ownership of both bottom-line results and the organization's cultural backbone.[50]

REMEMBER THIS

- There is evidence that companies that intentionally manage cultural values outperform similar companies that do not.
- Managers emphasize both values and business results to create a high-performance culture.
- The right culture can enable solid business performance through the alignment of motivated employees with the mission and goals of the company.

11.5 The Cultural Focus of Control Systems

Earlier in the chapter we described control systems as one element that reflects an organization's cultural norms and values. The ways in which managers control people and operations vary depending on the corporate culture. For example, a company such as Salesforce.com, which has primarily a clan culture as described previously, will handle control issues differently from one such as Anheuser-Busch InBev, which has an achievement culture. Managers consider both control of the overall organization and control of departments, teams, and individuals. Some control strategies apply to the top levels of an organization, where the concern is for the entire organization or major divisions. Control is also an issue at the lower, operational level, where department managers and supervisors focus on the performance of teams and individual employees.

11.5a The Changing Philosophy of Control

Managers' approach to control is changing in many organizations. In connection with the shift to employee participation and empowerment, many companies are adopting a *decentralized* rather than a *hierarchical* control process. Hierarchical control and decentralized control represent different philosophies of corporate culture. Most organizations display some aspects of both hierarchical and decentralized control, but managers generally emphasize one or the other, depending on the organizational culture and their own beliefs about control.

Hierarchical control involves monitoring and influencing employee behavior through extensive use of rules, policies, hierarchy of authority, written documentation, reward systems, and other formal mechanisms.[51] In contrast, decentralized control relies on cultural values, traditions, shared beliefs, and trust to foster compliance with organizational goals. Managers operate on the assumption that employees are trustworthy and willing to perform effectively without extensive rules and close supervision.

Exhibit 11.6 contrasts the use of hierarchical and decentralized methods of control. Hierarchical methods define explicit rules, policies, and procedures for employee behavior. Control relies on centralized authority, the formal hierarchy, and close personal supervision. Responsibility for quality control rests with quality control inspectors and supervisors rather than with employees. Job

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EXHIBIT 11.6

Hierarchical and Decentralized Methods of Control

	Hierarchical Control	Decentralized Control
Basic assumptions	People are incapable of self-discipline and cannot be trusted. They need to be monitored and controlled closely.	People work best when they are fully committed to the organization.
Actions	Uses detailed rules and procedures and formal control systems.	Features limited use of rules; relies on shared values, group and self-control, selection, and socialization.
	Uses top-down authority, formal hierarchy, position power, supervision, quality control inspectors.	Relies on flexible authority, flat structure, and expert power; everyone monitors quality.
	Relies on task-related job descriptions.	Relies on results-based job descriptions; emphasizes goals to be achieved.
	Emphasizes extrinsic rewards (pay, benefits, status).	Emphasizes extrinsic and intrinsic rewards (meaningful work, opportunities for growth).
	Features rigid organizational culture and distrust of cultural norms as means of control.	Features adaptive culture; culture recognized as means for uniting individual, team, and organizational goals for overall control.
Consequences	Employees follow instructions and do *just* what they are told.	Employees take initiative and seek responsibility.
	Employees feel a sense of indifference toward work.	Employees are actively engaged and committed to their work.
	Employee absenteeism and turnover is high.	Employee turnover is low.

Sources: Based on Naresh Khatri et al., "Medical Errors and Quality of Care: From Control to Commitment," *California Management Review* 48, no. 3 (Spring, 2006), 118; Richard E. Walton, "From Control to Commitment in the Workplace," *Harvard Business Review*, March–April 1985, 76–84; and Don Hellriegel, Susan E. Jackson, and John W. Slocum, Jr., *Management*, 8th ed. (Cincinnati, OH: South-Western, 1999), 663.

descriptions generally are specific and task-related, and managers define minimal standards for acceptable employee performance. In exchange for meeting the standards, individual employees are given extrinsic rewards such as wages, benefits, and possibly promotions up the hierarchy. Employees rarely participate in the control process, with any participation being formalized through mechanisms such as grievance procedures. With hierarchical control, the organizational culture is somewhat rigid, and managers do not consider culture a useful means of controlling employees and the organization. Technology often is used to control the flow and pace of work or to monitor employees, such as by measuring the number of minutes employees spend on phone calls or how many keystrokes they make at the computer.

The hierarchical approach to control is strongly evident in many Japanese companies. Japanese culture reflects an obsession with rules that can excel at turning chaos to order. For example, after the devastating 2011 earthquake and tsunami, the Japanese efficiently organized evacuation centers for families who lost homes during the disaster. Self-governing committees managed these temporary shelters and laid out in painstaking detail the daily responsibilities of the residents. People were assigned specific tasks, including sorting the garbage, washing the bathrooms, and cleaning fresh-water tanks. This hierarchical method of managing the temporary evacuation centers helped survivors find routine and responsibility, which could play a big role in reducing the long-term psychological and physical toll of this natural disaster.[52]

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Decentralized control is based on values and assumptions that are almost opposite to those of hierarchical control. Rules and procedures are used only when necessary. Managers rely instead on shared goals and values to control employee behavior. The organization places great emphasis on the selection and socialization of employees to ensure that workers have the appropriate values needed to influence behavior toward meeting company goals. No organization can control employees 100 percent of the time, and self-discipline and self-control are what keep people performing their jobs up to standard. Empowerment of employees, effective socialization, and training all can contribute to internal standards that provide self-control. Nick Sarillo, who owns two Nick's Pizza & Pub shops in Illinois, says his management style is "trust and track," which means giving people the tools and information they need, telling them the result they need to achieve, and then letting them get there in their own way. At the same time, Sarillo keeps track of results so the company stays on solid ground.[53]

With decentralized control, power is more dispersed and is based on knowledge and experience as much as formal position. The organizational structure is flat and horizontal, with flexible authority and teams of workers solving problems and making improvements. Everyone is involved in quality control on an ongoing basis. Job descriptions generally are results-based, with an emphasis more on the outcomes to be achieved than on the specific tasks to be performed. Managers use not only extrinsic rewards such as pay, but the intrinsic rewards of meaningful work and the opportunity to learn and grow. Technology is used to empower employees by giving them the information they need to make effective decisions, work together, and solve problems. People are rewarded for team and organizational success as well as their individual performance, and the emphasis is on equity among employees. Employees participate in a wide range of areas, including setting goals, determining standards of performance, governing quality, and designing control systems.

With decentralized control, the culture is adaptive, and managers recognize the importance of organizational culture for uniting individual, team, and organizational goals for greater overall control. Ideally, with decentralized control, employees will pool their areas of expertise to arrive at procedures that are better than managers could come up with working alone. Campbell's Soup is using decentralized control by enlisting its workers to help squeeze efficiency out of its plants. At the plant in Maxton, North Carolina, factory workers huddle every morning with managers to find ways to save the company money. These employees are part of a decentralized culture where both managers and employees share the company's goals and collaborate on ways to improve efficiency. The daily worker–manager huddles are about "getting everybody involved," says "Big John" Filmore, a 28-year plant veteran. "Instead of being told what to do, we get to tell people about our problems," he said.[54]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Choose between a primarily hierarchical or decentralized philosophy of control. With hierarchical control, use detailed rules and procedures, strong top-down authority, and formal control systems. With a decentralized philosophy, limit the use of strict rules and top-down authority and rely more on employee selection and socialization to build a culture of shared values that guide employee behavior.

11.5b Feedback Control Model

All effective control systems involve the use of feedback to determine whether organizational performance meets established standards to help the organization attain its goals. Managers set up systems for organizational control that consist of the four key steps in the **feedback control model** illustrated in Exhibit 11.7.

The cycle of control includes setting strategic goals for departments or the organization as a whole, establishing metrics and standards of performance, comparing

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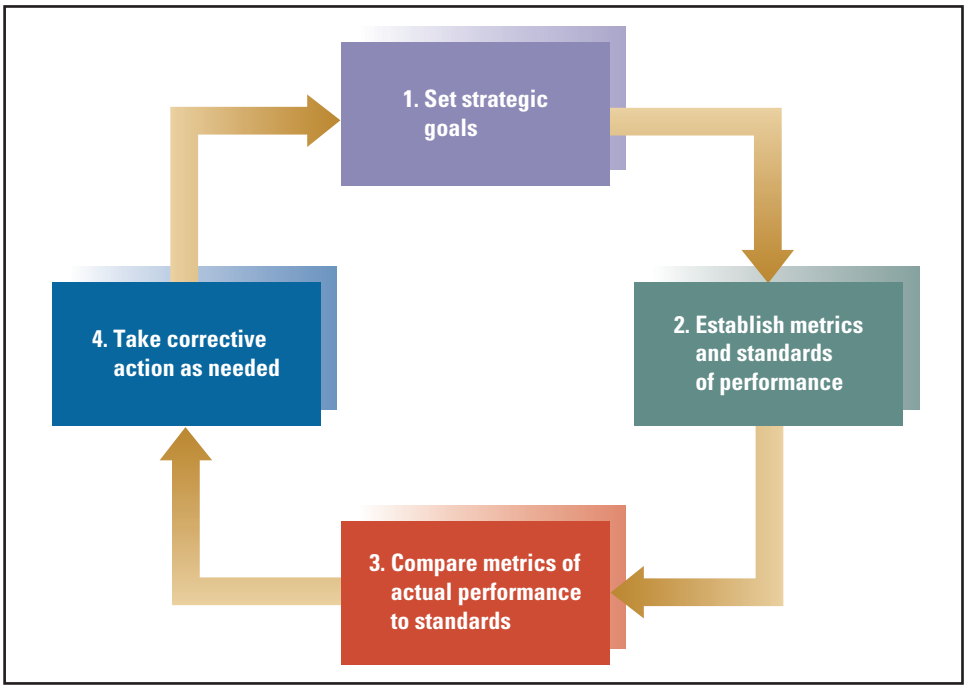
EXHIBIT 11.7
A Simplified Feedback Control Model


1. Set strategic goals
2. Establish metrics and standards of performance
3. Compare metrics of actual performance to standards
4. Take corrective action as needed

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Devise control systems that consist of the four essential steps of the feedback control model: set goals, establish standards of performance, measure actual performance, and correct or change activities as needed.

metrics of actual performance to standards, and correcting or changing activities as needed. For example, a goal for the Hershey Company is to have Hershey's Kisses "looking as great as they taste," said spokesman Jeff Beckman. Feedback from customers alerted Hershey to a deviation from standards. Bakers who were using the popular candy to adorn their holiday cookies were furious to find bags full of Kisses that were missing the tip on each piece of chocolate. "They baked ok but not with the nice pointy tip that I'm used to or expect from Hershey," one customer wrote in a blog post. "I'm still steaming!" Hershey executives are taking the matter seriously, said Beckman, exploring what went wrong and how to make sure all Hershey's Kisses come out looking the way they should.[55] Feedback control helps managers make needed adjustments in work activities, standards of performance, or goals to help the organization be successful.

Managers carefully assess what they will measure and how they define it. At Sprint Corporation, a new CEO discovered that the company was struggling because managers were measuring the wrong things. For example, managers in the customer care department focused on metrics that controlled costs but didn't solve customer problems. Consequently, Sprint had a terrible customer service reputation, was losing customers, and wasn't meeting its financial targets. A new CEO came on board and told managers to stop worrying about how long it took for a care agent to handle a call and start focusing on how effectively the agent solved the customer's problem. Before long, Sprint had moved way up in the consumer satisfaction ratings and was adding new customers.[56] Managers at most companies, like Sprint, use a number of carefully focused operational metrics to track performance and control the organization rather than rely on financial measures alone. Managers in many successful companies, including Google, Intel, and the Gates Foundation,

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use a system that relies on OKRs (objectives and key results). OKRs establish the target the organization wants to achieve and the results that help benchmark and monitor how it reaches them.[57] OKRs are set for all important areas of the business, and managers track metrics in such areas as customer satisfaction, product quality, employee commitment and turnover, operational performance, innovation, and corporate social responsibility, for example, as well as financial results.

11.5c Organization Level: The Balanced Scorecard

A recent control system innovation is to integrate internal financial measurements and statistical reports with a concern for markets and customers, as well as employees. The **balanced scorecard** (BSC) is a comprehensive management control system that balances traditional financial measures with operational measures relating to a company's critical success factors.[58] A BSC contains four major perspectives, as illustrated in Exhibit 11.8: financial performance, customer service, internal business processes, and the organization's capacity for learning and growth.[59]

Within these four areas, managers identify key performance indicators (KPIs) the organization will track. The *financial perspective* reflects a concern that the organization's activities contribute to improving short- and long-term financial performance. It includes traditional measures such as net income and return on investment. *Customer service indicators* measure such things as how customers view the organization as well as customer retention and satisfaction. *Business process indicators* focus on production and operating statistics, such as order fulfillment or cost per order. The final component looks at the organization's *potential for learning and growth,* focusing on how well resources and human capital are being managed for the company's future. Measurements include such things as employee retention, business process improvements, and the introduction of new products. The components of the scorecard are designed in an integrative manner so that they reinforce one another as illustrated in Exhibit 11.8 by linking short-term actions within each of the four perspectives to each other and to the overall mission, strategy and goals. Managers can use the scorecard to set goals, allocate resources, plan budgets, and determine rewards.

Although these elements sound like they apply most clearly to product-based firms, the scorecard can also be applied to both for-profit and nonprofit service organizations. A large technology service provider, for example, identified KPIs of return on equity (financial), number of ideas implemented within the past year (learning and growth), accuracy and responsiveness (internal processes), and customer loyalty and retention (customer service), among others.[60] The scorecard has become the core management control system for many service organizations, including Hilton Hotels, Allstate, British Airways, and Cigna Insurance. British Airways clearly ties its use of the BSC to the feedback control model shown earlier in Exhibit 11.7. Scorecards serve as the agenda for monthly management meetings, where managers evaluate performance, discuss what corrective actions need to be taken, and set new targets for the various BSC categories.[61]

In recent years, the BSC has evolved into a system that helps managers see how organizational performance results from cause–effect relationships among these four mutually supportive areas. Overall effectiveness is a result of how well these four elements are aligned, so that individuals, teams, and departments are working in concert to attain specific goals that cause high organizational performance.[62]

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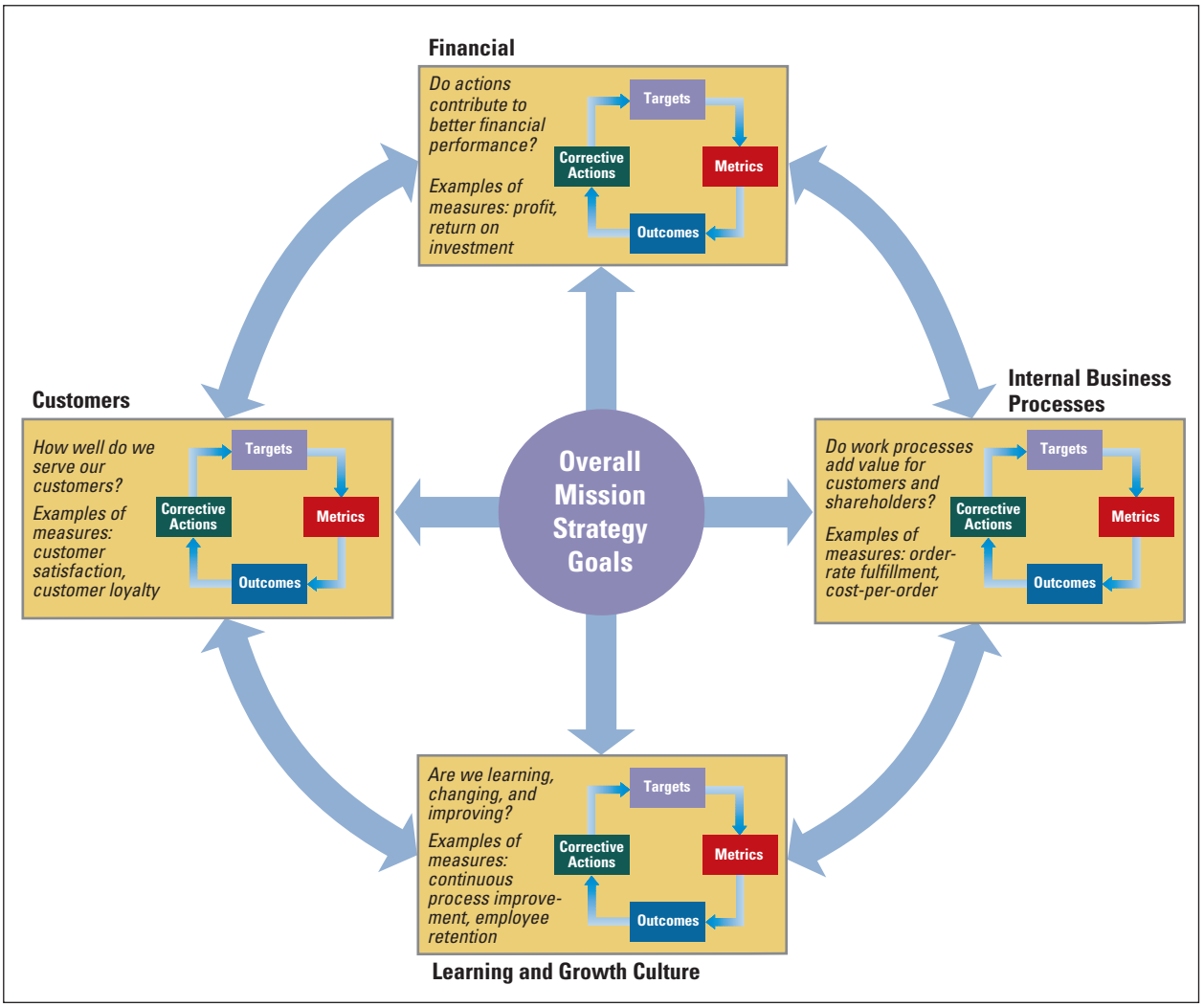
EXHIBIT 11.8

Major Perspectives of the Balanced Scorecard


Financial
Do actions contribute to better financial performance?
Examples of measures: profit, return on investment
Targets
Metrics
Outcomes
Corrective Actions
Customers
How well do we serve our customers?
Examples of measures: customer satisfaction, customer loyalty
Internal Business Processes
Do work processes add value for customers and shareholders?
Examples of measures: order-rate fulfillment, cost-per-order
Overall Mission Strategy Goals
Are we learning, changing, and improving?
Examples of measures: continuous process improvement, employee retention
Learning and Growth Culture

Sources: Based on Robert S. Kaplan and David P. Norton, "Using the Balanced Scorecard as a Strategic Management System," *Harvard Business Review*, January–February 1996, 75–85; Chee W. Chow, Kamal M. Haddad, and James E. Williamson, "Applying the Balanced Scorecard to Small Companies," *Management Accounting* 79, no. 2 (August 1997), 21–27; and Cathy Lazere, "All Together Now," *CFO*, February 1998, 28–36.

The cause–effect control technique is the strategy map. A **strategy map** provides a visual representation of the key drivers of an organization's success and shows how specific outcomes in each area are linked.[63] The strategy map is a powerful way for managers to see the cause–effect relationships among various performance metrics. The simplified strategy map shown in Exhibit 11.9 illustrates the four key areas that contribute to a firm's long-term success—a learning and growth culture, internal processes, customer service, and financial performance—and how the various outcomes in one area link directly to performance in another area. The idea is that effective performance in terms of learning and growth serves as a foundation

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to help achieve excellent internal business processes. Excellent business processes, in turn, enable the organization to achieve high customer service and satisfaction, which enables the organization to reach its financial goals and optimize its value to all stakeholders.

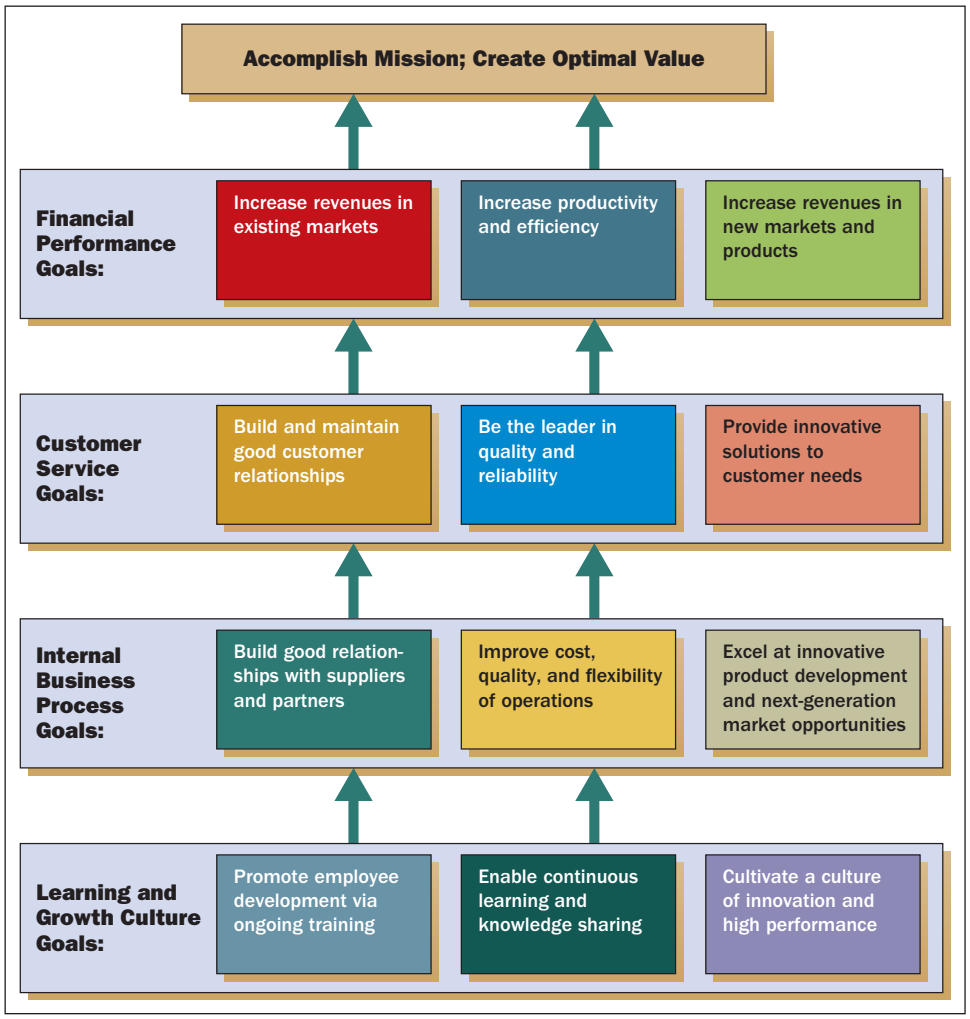
In the strategy map shown in Exhibit 11.9, the organization has learning and growth goals that include employee training and development, continuous learning and knowledge sharing, and building a culture of innovation. Achieving these goals will help the organization build efficient internal business processes that promote good relationships with suppliers and partners, improve the quality and flexibility of operations, and excel at developing innovative products and services.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Use a balanced scorecard to integrate various control dimensions and get a more complete picture of organizational performance. Select indicators in the areas of financial performance, customer service, internal processes, and learning and growth, and consider a strategy map to visualize how outcomes are linked.

EXHIBIT 11.9
A Strategy Map for Performance Management


Accomplish Mission; Create Optimal Value
Financial Performance Goals:
Increase revenues in existing markets
Increase productivity and efficiency
Increase revenues in new markets and products
Customer Service Goals:
Build and maintain good customer relationships
Be the leader in quality and reliability
Provide innovative solutions to customer needs
Internal Business Process Goals:
Build good relationships with suppliers and partners
Improve cost, quality, and flexibility of operations
Excel at innovative product development and next-generation market opportunities
Learning and Growth Culture Goals:
Promote employee development via ongoing training
Enable continuous learning and knowledge sharing
Cultivate a culture of innovation and high performance

Sources: Based on Robert S. Kaplan and David P. Norton, "Mastering the Management System," *Harvard Business Review*, January 2008, 63–77; and Robert S. Kaplan and David P. Norton, "Having Trouble with Your Strategy? Then Map It," *Harvard Business Review*, September–October 2000, 167–176.

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Accomplishing internal process goals, in turn, enables the organization to maintain strong relationships with customers, be a leader in quality and reliability, and provide innovative solutions to emerging customer needs. At the top of the strategy map, the accomplishment of these lower-level goals helps the organization increase revenues in existing markets, reduce costs through better productivity and efficiency, and grow by selling new products and services in new market segments.

In a real-life organization, the strategy map would typically be more complex and would state concrete, specific goals, desired outcomes, and metrics relevant to the particular business. However, the generic map shown in Exhibit 11.9 gives an idea of how managers can use strategy maps to set goals, track metrics, assess performance, and make changes as needed.

11.5d Department Level: Behavior Versus Outcome Control

The BSC and strategy map are techniques used primarily by top executives and upper-level managers. Lower-level managers focus on the performance of people at the department level, who must meet goals and standards if the organization is to attain its overall goals.

The reward system is often of paramount concern at the supervisory level. There are two different approaches to evaluating and controlling team or individual performance and allocating rewards. One approach focuses primarily on *how* people do their jobs, whereas the other focuses primarily on the *outcomes* people produce.[64] **Behavior control** is based on managers' direct observation and supervision of employee actions to see whether the individual follows rules and policies and performs tasks as instructed. Do people get to work on time? Do they stay focused on their tasks or spend a lot of time socializing with colleagues? Do they dress appropriately for the job? Do they perform their jobs according to established methods or supervisor instructions? With behavior control, managers provide heavy supervision and monitoring, pay attention to the methods people use to accomplish their jobs, and evaluate and reward people based on specific criteria, which might include areas such as appearance, punctuality, skills, and activities. Managers at Chipotle increased behavior control after a string of illnesses were linked to the Mexican restaurant chain several years ago. The company's new executive director of food safety installed kitchen timers that reset every 30 minutes to remind employees who are preparing food to stop what they're doing and wash their hands.[65]

Digital technology has increased the potential for managers to use behavior control. For example, Dennis Gray, owner of Accurid Pest Solutions, suspected that some of his employees were spending too much time on personal issues during the workday. He installed GPS tracking software on the company-issued smartphones and found that one employee was visiting the same address several times a week. The employee admitted he was blowing off work and meeting a friend. A survey found that 37 percent of companies that send workers out on service calls now track the real-time location of employees via their handheld devices or vehicles.[66] Managers in many companies monitor employees' e-mail and other online activities. Many restaurants and retailers use theft-monitoring software.[67]

A second approach to control is to pay less attention to what people *do* than to what they *accomplish*. **Outcome control** is based on monitoring and rewarding

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results, and managers might pay little attention to how those results are obtained. With outcome control, managers don't supervise employees in the traditional sense. People have a great deal of autonomy in terms of how they do their jobs—and sometimes in terms of where and when they do their jobs—as long as they produce desired outcomes. Rather than monitoring how many hours an employee works, for example, managers focus on how much work the employee accomplishes.

The Results-Only Work Environment (ROWE) program at Best Buy provides an illustration of outcome control carried to the extreme. When Best Buy managers noticed an alarming increase in turnover of headquarters employees, they began looking for ways to reverse the trend. They realized that the Best Buy culture that emphasized long hours, mandatory procedures, and managers "acting like hall monitors" was no longer working. A new system allowed people to work when and where they wanted as long as they got the job done. The experiment started in one department where morale had reached a dismal low. It worked so well that it eventually spread throughout headquarters. The results? From 2005 to 2007, the turnover rate in departments using ROWE decreased nearly 90 percent, while productivity shot up 41 percent. Although the ROWE system was discontinued as Best Buy went into a decline, it worked extremely well as a means of outcome control. Senior Vice President John Thompson, who was at first skeptical, became a strong believer when he saw the results. "I was always looking to see if people were here. I should have been looking at what they were getting done," Thompson said.[68]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Don't overdo the use of behavior control. Set some reasonable guidelines for behavior and work activities but emphasize outcome control by focusing on results and allowing employees some discretion and autonomy about how they accomplish outcomes.

3 For a department manager, it should not matter much exactly how or when people get their work done, just as long as they produce good results.

ASSESS YOUR ANSWER

ANSWER: *Agree.* Focusing on results, or outcomes, can be a highly effective approach to department level control in many organizations. Employees resent being micromanaged and don't like being treated like children. Most managers find it necessary to set some reasonable boundaries for correct behavior, but greater control emphasis is placed on outcome control to achieve highest performance.

With effective outcome control, digital technology is used not to monitor and control individual employee behavior but rather to assess performance outcomes. For example, at Best Buy, the manager of the online orders department could use IT to measure how many orders per hour his team processed, even if one team member was working down the hall, one working from home, one taking the afternoon off, and another working from her vacation cabin 400 miles away.[69] Good performance metrics are key to making an outcome control system work effectively.

However, outcome control is not necessarily the best for all situations. In some cases, behavior control is more appropriate and effective, but in general, managers in successful organizations are moving away from closely monitoring and controlling behavior toward allowing employees more discretion and autonomy in how they do their jobs. In most organizations, managers use both behavior and outcome control.

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REMEMBER THIS

- Many organizations are shifting from a *hierarchical* to a *decentralized* control process that relies on shared cultural values rather than strict rules and close supervision for control.
- All effective control systems involve the use of feedback. The feedback control model includes setting strategic goals, establishing metrics and standards of performance, comparing actual performance to standards, and taking corrective action as needed.
- At the organization level of control, an innovation called the *balanced scorecard* provides managers with a balanced view of the organization by integrating traditional financial measurements and statistical reports with a concern for markets, customers, and employees. Managers also use strategy maps to see the cause–effect relationships among these critical success factors.
- At the department level, managers may use behavior control or outcome control. Behavior control involves close monitoring of employee activities, whereas outcome control measures and rewards result outcomes.
- Most managers use a combination of behavior and outcome control, with a greater emphasis on outcome control because it leads to better performance and higher motivation.

KEY CONCEPTS

achievement culture
adaptability culture
balanced scorecard
behavior control
bureaucratic culture
clan culture
culture
culture strength
decentralized control
external adaptation
feedback control model
heroes
hierarchical control
high-performance culture
internal integration
legends
outcome control
rites and ceremonies
sayings
social capital
stories
strategy map
subcultures
symbol

DISCUSSION QUESTIONS

1. How much do you think it is possible for an outsider to discern about the underlying cultural values of an organization by analyzing symbols, ceremonies, dress, or other observable aspects of culture, compared to an insider with several years of work experience? Specify a percentage (e.g., 10 percent, 70 percent) and discuss your reasoning.
2. Many of the companies on *Fortune* magazine's list of most admired companies are also on its list of most profitable ones. Some people say this proves that high social capital translates into profits. Other people suggest that high profitability is the primary reason the companies have a good culture and are admired in the first place. Discuss your thinking about these two differing interpretations.
3. Describe the four elements of the feedback control model. Which of these elements is more similar to behavior control? Outcome control?
4. In which of the four cultures described in Exhibit 11.4 would you prefer to work? Why?
5. How might the symbols apparent in a business college differ from symbols in a school of social work? If you have access to both types of schools, walk through them and record any differences you see.
6. Do you think strong subcultures would be a good thing for an organization? Why?
7. What importance would you attribute to leadership statements and actions for influencing cultural values in an organization? Explain.

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8. Would you prefer to work in an organization with a tight or a loose culture (BookMark)? Explain why.
9. Why do you think Learning and Growth Culture Goals are at the bottom of the Strategy Map in Exhibit 11.9? Discuss.
10. How would you describe the major differences between a hierarchical philosophy of control and a decentralized philosophy of control? Which philosophy of control would be easier for a manager to implement? Discuss.

CHAPTER 11 WORKSHOP Balanced Scorecard Exercise

1. **Instructions:** Individually read the measures and objectives below for a business firm. Make a check for each objective/measure item in the correct balanced scorecard column. If you think an objective/measure fits into two balanced scorecard categories, write the numbers 1 and 2 for your first and second choices.
2. In small groups of 3–4 students, compare your chosen categories for each objective/measure item and reach agreement on the correct category.
3. In your small group, select and discuss the five objective/measure items your group thinks would be most important for helping build a positive corporate culture.

Business Firm	Financial	Customers	Business Processes	Learning & Growth
Return on capital employed (ROCE)	_____	_____	_____	_____
Build employee recreation venue by December 2020	_____	_____	_____	_____
Develop new products within a time period of eight months	_____	_____	_____	_____
Provide team leader training program by July 2019	_____	_____	_____	_____
Achieve 98 percent customer satisfaction by December 2019	_____	_____	_____	_____
Number of monthly customer complaints	_____	_____	_____	_____
Reduce cost per unit sold by 10 percent	_____	_____	_____	_____
Increase customer retention by 15 percent	_____	_____	_____	_____
Improve employee job satisfaction scores by 20 percent	_____	_____	_____	_____
Lead market in speed of delivery by 2020	_____	_____	_____	_____
Lowest industry cost by 2020	_____	_____	_____	_____
Improve profits by 12 percent over last year	_____	_____	_____	_____
Budget forecast accuracy	_____	_____	_____	_____
Introduce three new products by December 2020	_____	_____	_____	_____
Percentage of employee training completed	_____	_____	_____	_____
Number of leaders ready for promotion	_____	_____	_____	_____
Completed succession plan	_____	_____	_____	_____
Percentage of part-time employees	_____	_____	_____	_____
Sales growth to increase one percent monthly	_____	_____	_____	_____
Number of employee grievances	_____	_____	_____	_____
Employee engagement scores	_____	_____	_____	_____
Number of employee terminations	_____	_____	_____	_____
Policy implementation time lag	_____	_____	_____	_____
Vendor on-time delivery rate	_____	_____	_____	_____
Total annual revenues	_____	_____	_____	_____
Utility consumption costs	_____	_____	_____	_____
Workers' compensation claims	_____	_____	_____	_____
EBITDA	_____	_____	_____	_____

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CASE FOR ANALYSIS | Midwest Controls, Inc.[70]

Curtis Simpson sat staring out the window of his office. What would he say to Tom Lawrence when they met this afternoon? Tom had clearly met the challenge Simpson set for him when he hired him as president of Midwest Controls, Inc. a little more than a year ago, but the company seemed to be coming apart at the seams. As chairman and CEO of Simpson Industries, which had bought Midwest several years ago, Simpson was faced with the task of understanding the problem and clearly communicating his ideas and beliefs to Lawrence.

Midwest Controls, Inc. (Midwest) is a medium-sized producer of mechanical seals, valves, pumps, and other flow-control products. When Simpson Industries acquired the company, it was under the leadership of Jim Carpenter, who had been CEO for almost three decades and was very well liked by employees. Carpenter had always treated his employees like family. He knew most of them by name, often visited them in their homes if they were ill, and spent part of each day just chatting with workers on the factory floor. Midwest sponsored an annual holiday party for its workers as well as company picnics and other social events several times a year, and Carpenter was always in attendance. He considered these activities to be just as important as his visits with customers or negotiations with suppliers. Carpenter believed it was important to treat people right so they would have a sense of loyalty to the company. If business was slow, he would find something else for workers to do, even if it was just sweeping the parking lot, rather than lay people off. He figured the company couldn't afford to lose skilled workers who were so difficult to replace. "If you treat people right," he said, "they'll do a good job for you without your having to push them."

Carpenter had never set performance objectives and standards for the various departments, and he trusted his managers to run their departments as they saw fit. He offered training programs in communications and HR for managers and team leaders several times each year. Carpenter's approach had seemed to work quite well for much of Midwest's history. Employees were very loyal to Carpenter and the company, and there were many instances in which workers had gone above and beyond the call of duty. For example, when two Midwest pumps that supplied water to a U.S. Navy ship failed on a Saturday night just before the ship's scheduled departure, two employees worked throughout the night to make new seals and deliver them for installation before the ship left port. Most managers and employees had been with the company for many years, and Midwest boasted the lowest turnover rate in the industry.

However, as the industry began to change in recent years, Midwest's competitiveness began to decline. Four of Midwest's major rivals had recently merged into two large companies that were better able to meet customer needs, which was one factor that led to Midwest being acquired by Simpson Industries. Following the acquisition, Midwest's sales and profits had continued to decline, while costs kept going up. In addition, Simpson Industries' top executives were concerned about low productivity at Midwest. Although they had been happy to have Carpenter stay on through the transition, within a year they had gently pressured him into early retirement. Some of the top managers believed Carpenter tolerated poor performance and low productivity in order to maintain a friendly atmosphere. "In today's world, you just can't do that," one had said. "We've got to bring in someone who can implement change and turn this company around in a hurry, or Midwest's going to go bankrupt." That's when Tom Lawrence was brought on board, with a mandate to cut costs and improve productivity and profits.

Lawrence had a growing reputation as a young, dynamic manager who could get things done fast. He quickly began making changes at Midwest. First, he cut costs by discontinuing the company-sponsored social activities, and he even refused to allow the impromptu birthday celebrations that had once been a regular part of life at Midwest. He cut the training programs in communications and HR, arguing that they were a waste of time and money. "We're not here to make people feel good," he told his managers. "If people don't want to work, get rid of them and find someone else who does." He often referred to workers who complained about the changes at Midwest as "cry-babies."

Lawrence established strict performance standards for his vice presidents and department managers and ordered them to do the same for their employees. He held weekly meetings with each manager to review department performance and discuss problems. All employees were now subject to regular performance reviews. Any worker who had substandard performance was to be given one warning and then fired if performance did not improve within two weeks. Moreover, whereas managers and sales representatives had once been paid on a straight salary basis, with seniority being the sole criterion for advancement, Lawrence implemented a revised system that rewarded them for meeting productivity, sales, and profit goals. For those who met the standards, rewards were generous, including large bonuses and perks such as company cars and first-class air travel to industry meetings. Those who fell behind were often chided in front of their colleagues to set an example, and if they didn't shape up soon, Lawrence didn't hesitate to fire them.

By the end of Lawrence's first year as president of Midwest, production costs had been reduced by nearly

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20 percent, while output was up 10 percent and sales increased by nearly 10 percent as well. However, three experienced and well-respected Midwest managers had left the company for jobs with competitors, and turnover among production workers had increased alarmingly. In the tight labor market, replacements were not easily found. Most disturbing to Simpson were the results of a survey he had commissioned by an outside consultant. The survey indicated that morale at Midwest was in the pits. Workers viewed their supervisors with antagonism and a touch of fear. They expressed the belief that managers were obsessed with profits and quotas and cared nothing about workers' needs and feelings. They also noted that the collegial, friendly atmosphere that had made Midwest a great place to work had been replaced by an environment of aggressive internal competition and distrust.

Simpson was pleased that Lawrence has brought Midwest's profits and productivity up to the standards Simpson Industries expects. However, he was concerned that the low morale and high turnover would seriously damage the company in the long run. Was Lawrence correct that many of the employees at Midwest are just being "cry-babies"? Were they so accustomed to being coddled by Carpenter that they weren't willing to make the changes necessary to keep the company competitive? Finally, Simpson wondered if a spirit of competition can exist in an atmosphere of collegiality and cooperativeness such as that fostered by Carpenter.

Questions

1. Which of the four types of culture in Exhibit 11.4 would you say best describes Midwest's corporate culture under the leadership of Carpenter? Under that of Lawrence? Which culture is more appropriate for Midwest?
2. Within the culture established by Tom Lawrence, is it possible to return to high morale and lower turnover?How might Lawrence do that?
3. In which quadrant of Exhibit 11.5 would you place Lawrence? If you were Curtis Simpson, what would you say to Tom Lawrence in your upcoming meeting with him?

CASE FOR ANALYSIS | NASCAR

NASCAR fans expect their drivers to be smart, crafty, and calculating and, if need be, playing just this side of the rule book—in the garage and on the track. Loyal fans "know" their drivers and can easily picture themselves drinking a beer or spending an afternoon tinkering under the hood with a favorite driver. In the wild, fast-paced world of NASCAR, drivers can joke and pal around with competitors one day and trade word-for-word or, if necessary, fist-for-fist with a rival the next day. They defiantly wear monikers like "Fireball" and "The Intimidator."

And why not? The roots of the sport trace back to Prohibition when moonshine runners in souped-up cars raced across the hills of Appalachia outsmarting and outrunning the "Feds" and "Revenuers," taking risks with life and the law to make deliveries. As reputations grew, the desire for head-to-head competition to establish bragging rights resulted in informal races.

As the popularity of these races increased, one driver, Big Bill France, gathered drivers and set up a meeting in Daytona in December 1947 to establish and standardize rules for the many tracks scattered across the region. At that meeting, a new governing organization, the National Association for Stock Car Auto Racing (NASCAR) was born. Two months later, drivers met in the first NASCAR sanctioned race.

Across decades, NASCAR has remained a "family business." Jim France, the son of NASCAR cofounder Bill France Sr. (Big Bill), serves as Chairman and CEO. Still headquartered in Daytona, with offices scattered around the country, NASCAR has expanded into Mexico and Canada. "The Boys" became "Big Business" and the nation's second largest spectator sport with television coverage in over 150 countries and team sponsorships attracting Fortune 500 companies.

By contrast, the majority of the racing teams remained based in the hills around Charlotte, North Carolina, setting up an organizational tug-of-war. Drivers and the fan base remain faithful to traditional stock car racing and to the traditional tracks, devoted to the notion of "let the boys drive," including rule-breaking to gain an advantage.

The outlaw image is cherished by NASCAR's fan base, as one sports columnist warned: "If the outlaw blood ever is completely drained, then NASCAR will be as colorless as the white flag that signals one lap to go. And its popularity could be just as fleeting."

From the beginnings to recent history, it would appear there are few worries about the loss of that "outlaw image" and controversies are epic. In 1983, Richard Petty's Charlotte victory was allowed to "stand" despite over-the-limit engine cylinders. To the delight of fans, popular driver Junior Johnson continued the wild ways of his youth running moonshine for his dad, sneaking in illegal car modifications when he could, if it meant tearing down and rebuilding a car. He often got into trouble with NASCAR, but stock car traditionalists were thrilled.

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Two of the sport's biggest scandals occurred in 2001 and 2013. In a NASCAR move overshadowed by the death of Dale Earnhardt Sr. at the 2001 Daytona 500, eighteen teams were fined/penalized for rules violations. At Richmond in 2013, another six teams were penalized and fined. In that rules violation dragnet, Michael Waltrip Racing made NASCAR history with the largest-ever fine ($300,000), a penalty of 100 championship points, and a penalty of 100 team points when one of the teams caused a caution flag so another team could qualify for NASCAR's final 10-race Chase. In 2007 Waltrip was fined for the use of what fans and the media have come to call "rocket fuel." Year after year, drivers and crews get angry, apologize, and then shrug off the controversies as they continue to search for the "winning edge."

At the other end of the tug-of-war lies corporate NASCAR, the media, and sponsors concerned about image and any hint of impropriety—a modern version of those chasing the moonshine runners. *Their* focus is on safety, rules, fines, and penalties. The NASCAR rule book is in a constant state of growth and revision. Along with pre-race inspections, the winning vehicle is stripped down and examined for any evidence of tampering or cheating. There are currently six penalty levels for rule violations for drivers, crews, and vehicles ranging from P-1 (minor infractions) to P-6 (suspension).

Even the crucial area of driver safety enters into this cultural tug-of-war. Drivers claim that NASCAR is more concerned with the crackdown on rules violations than on driver safety. NASCAR's focus ranges from assigning and revoking car numbers at will, and the strict enforcement of a no-communications ban between crews/drivers and their rivals, to points penalties for drivers who refuse to talk to the media. Teams point out the frequency with which serious issues such as safety regulations seem to *follow* high-profile wrecks and deaths.

Fire retardant suits were required following the fiery death of Glen "Fireball" Roberts. The throttle "kill-switch" came on the heels of Adam Petty's death. Rules governing G-forces on drivers during crashes came after a series of deaths in 2000–2001. And the relocation of the driver's seat near the center of the vehicle, along with the requirement for installation of HANS (Head & Neck Support Device) came after the death of Dale Earnhardt.

Meanwhile, sport officials and sponsors appear to freak out over minute vehicle modifications that can give a driver an edge. Those modifications are not unethical, say stock car traditionalists; they are part of the culture—rivals and team crews discovering that undetectable edge that brings victory.

In 2014, then-CEO Brian France and NASCAR suddenly threw a monkey-wrench into tradition in a move that was both exciting for spectators and dangerous for drivers. In a sudden shift, NASCAR set new rules for qualifying, replacing the one-car-at-a-time-against-the-clock qualifying with a new all-cars-on-the-track-at-once qualifying round. In 2019, the group sessions were replaced by a return to single car runs.

As the sport enters a new era under the leadership of a new CEO, observers might ask how the NASCAR organization, teams, and sponsors might work through issues of values to create a unified culture.

Questions

1. How would you describe the culture of NASCAR racing teams? How are these cultural values manifested?
2. Describe the culture war at NASCAR. What is your evidence?
3. How might the NASCAR organization, teams and sponsors work through differences to create a unified culture? What do you think a unified culture would mean for all parties?

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CHAPTER

12 Innovation and Change

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Learning Objectives

After reading this chapter you should be able to:

1. Describe the types of strategic innovation.
2. Explain the necessary elements for successful organizational change.
3. Compare and contrast techniques for encouraging technology innovation with those that encourage product and service innovation.
4. Explain how innovation speed provides a competitive advantage.
5. Describe the dual-core approach to organizational change.
6. Explain how a large group intervention can be used to bring about culture change in an organization.
7. List techniques for overcoming resistance to change.

Chapter Outline

The Strategic Role of Innovation

Innovate or Be Disrupted • Strategic Types of Innovation

Elements for Successful Change

Technology Innovation

The Ambidextrous Approach • The Bottom-Up Approach • Techniques for Encouraging Technology Change

New Products and Services

New Product Success Rate • Reasons for New Product Success • Horizontal Coordination Model • Open Innovation and Crowdsourcing • The Need for Speed

Strategy and Structure Change

The Dual-Core Approach • Organization Design for Implementing New Management Processes

Culture Change

Forces for Culture Change • Culture Change Interventions

Tactics for Implementing Change

Leadership for Change • Techniques for Implementation • Techniques for Overcoming Resistance

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MANAGING BY DESIGN QUESTIONS

Before reading this chapter, please check whether you agree or disagree with each of the following statements:

1 **The most important aspect for creating an innovative company is requiring people to come up with new ideas.**

I AGREE _____ I DISAGREE _____

2 **Asking customers what they want is the best way to create new products that will be successful in the marketplace.**

I AGREE _____ I DISAGREE _____

3 **Changing a company's culture is probably one of the hardest jobs a manager can undertake.**

I AGREE _____ I DISAGREE _____

Do you like your Sprite with a splash of cucumber flavoring? You can buy it ready-made that way in Russia. Do you add a little coffee to your Coca-Cola? Then you might want to get your hands on the company's new drink in Australia. The Coca-Cola Company introduced around 500 new drinks in one recent year, including a chunky mango juice in India, a line of whey shakes in Brazil, and a sesame-and-walnut drink in China, as well as variations of popular sodas such as Sprite and Coke. Coca-Cola's Indian subsidiary came up with Maaza Chunky to mimic the experience of sucking the pulp out of a fresh mango. "We have this mandate now to go create products and business which are much more in tune with local needs, said Shehnaz Gill, a Coke executive in India. Other new flavors in India include a spicy cumin-flavored soda and a gritty guava drink. Coca-Cola's CEO James Quincey is pushing subsidiaries around the world to come up with more local drinks, get them into the marketplace fast, and just as quickly pull the ones that don't work out so well. "We're not betting the ranch on every idea until it's proven to have some traction," Quincey said. In India, it used to take a year to get a new product on the market; now a new drink can move from idea to store shelves in about four months.[1]

Companies and managers are searching for any innovation edge they can find. Getting new products and services on the market quickly is key to keeping up with changes in the external environment. New discoveries, new inventions, and new approaches quickly replace standard ways of doing things. Tremendous leaps in technology have revolutionized the way we live. Many of us now text and tweet and "friend" people online more often than we interact with them face to face. The pace of change is revealed in the fact that many parents of today's college students grew up without iPads, social media, global positioning systems, streaming video, and even the Internet. As teenagers, many parents couldn't have imagined communicating instantly or playing video games with people around the world, carrying all their favorite music with them wherever they went, or downloading an entire book onto a device as small as a notepad. High-tech industries seem to change every nanosecond, so companies such as Apple, Google, Netflix, Facebook, and Twitter are continually innovating to keep up. But companies in all industries face greater pressures for innovation today. Bob Jordan, executive vice president of corporate services for Southwest Airlines, spoke for managers all over the world when he said, "We have to innovate to survive."[2]

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Purpose of This Chapter

This chapter explores how organizations change and how managers direct the innovation and change process. First, we look at how difficult innovation can be and discuss the challenge of disruptive innovation. The next section describes the four types of innovation—technology, product, structure, people—occurring in organizations, and how to manage change successfully. The chapter then describes the organization structure and management approach for facilitating each type of innovation. Management techniques for influencing both the creation and implementation of change are also covered. The final section of the chapter looks at implementation techniques managers can use to successfully implement change and innovation.

12.1 The Strategic Role of Innovation

If there is one theme or lesson that emerges from previous chapters, it is that organizations must run fast to keep up with changes taking place all around them. Large organizations must find ways to act like small, flexible organizations. Manufacturing firms need to reach out for new smart manufacturing technology and service firms for new information technology (IT). Today's organizations must keep themselves open to continuous innovation, not only to prosper but merely to survive in a world of disruptive change and increasingly stiff competition.

12.1a Innovate or Be Disrupted

Powerful environmental forces drive the need for major organizational change.[3] Technological advances, changing markets, increasing government regulation, e-business and mobile commerce, shifting social attitudes, global economic turbulence, social media and the digital information revolution, and the growing power of Arab countries and the BRIC nations (Brazil, Russia, India, and China) have brought about an uncertain globalized economy that affects every business, from the largest to the smallest, creating more threats as well as more opportunities.

Organizations can respond to environmental shifts with three types of change and innovation.[4] *Episodic change* is what many long-time managers are accustomed to. This type of change occurs occasionally, with periods of relative stability, and managers can respond with technical, product, or structural innovations as needed. Most organizations today, however, experience *continuous change* because of a rapidly shifting environment. This type of change occurs frequently, with fewer and shorter periods of stability. Managers embrace change as an ongoing organizational process, using research and development (R&D) to build a flow of new product and service innovations to meet shifting needs. In many industries today, the environment has become so turbulent that managers encounter *disruptive change and innovation*.

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EXHIBIT 12.1
Stages of Disruptive Innovation

Stage 1
• Some new or unexpected technology, product, or service emerges on a small scale that poses a potential threat to established companies.
• Examples: The first commercial steamship—dismissed as never able to compete with sailing ships; Japanese cars—dismissed as too small and not powerful enough for American consumers; online bookstores—people like going to physical bookstores; MOOCs—students will miss the campus experience
Stage 2
• Established companies ignore these small potential threats, wanting to hold onto their current business models.
• Examples: Sailors and transoceanic sailing ship companies added steam engines to their sailing vessels but didn't embrace the pure steamship model; GM and other U.S. automakers eventually began building smaller cars, but it was too late to seriously compete with the Japanese; Amazon had already won the bookstore war by the time booksellers accepted that online bookselling was here to stay; most colleges offer online courses but few are changing their existing model, leaving them vulnerable as students gravitate toward less-expensive options
Stage 3
• Previously unnoticed companies, products, and services grow into a sizable force that is wrecking the established business model.
• Examples: By the early 1900s, with steam able to power a ship across the ocean on its own, every transoceanic sailing-ship company went out of business; Japanese automakers virtually won the small-car market; there are very few brick-and-mortar bookstores still in business; colleges and universities around the country are facing budget crises

Sources: Based on Clayton M. Christensen and Michael B. Horn, "Innovation Imperative: Change Everything," *The New York Times*, November 1, 2013, http://www.nytimes.com/2013/11/03/education/edlife/online-education-as-an-agent-of-transformation.html?_r=0 (accessed May 15, 2014); and Melissa A. Korn, "Coursera Defends MOOCs as Road to Learning," *The Wall Street Journal*, May 15, 2013, B5.

As shown in Exhibit 12.1, **disruptive innovation** refers to innovations in products or services that typically start small and end up completely replacing an existing product or service technology for producers and consumers. Companies that initiate a disruptive innovation typically win big; companies affected by a disruptive innovation may be put out of business. Established companies typically ignore the initial small innovation because they want to hang onto their established business models. Most students probably aren't old enough to remember how American car companies poked fun at the first automobiles from Japan, but GM and Ford managers stopped laughing when cars from Toyota and Subaru began stealing market share. Traditional media companies are facing a similar disruption from streaming services such as Netflix.

IN PRACTICE

Netflix

"Netflix is public enemy No. 1," said Bert Salke, the head of Fox 21 Television Studios. What a change that is from the company's early days. Software engineers Reed Hastings and Marc Rudolph started Netflix in 1997 to rent DVDs over the Internet, and it moved into streaming video in 2007. In 2000, with Netflix losing money, Hastings offered to sell the company to Blockbuster for $50 million, but the giant video rental company turned down his offer. Within a few years, Blockbuster was struggling. By 2019, Blockbuster was dead and Netflix was thriving.

(*continued*)

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You would think the big media companies would have paid attention, but when Netflix began "dabbling" in original programming, launching both "House of Cards" and "Orange Is the New Black" in 2013, executives at traditional media companies scoffed. Television networks and movie studios thought of Netflix primarily as a means to extend the life of their own programming. By licensing shows to Netflix, they could squeeze more money out of expensive programs. After the 2018 Netflix-produced film "Roma" won three Academy Awards, including Best Foreign Language Film, things took a decided turn in the "upstart's" favor. By the end of 2018, Netflix offered about 1,000 original television shows and movies and had more than 130 million subscribers for its streaming service. The company has been hiring executives away from companies such as 21st Century Fox and NBCUniversal Television and luring away top production and acting talent. "It's a feeding frenzy to get the best people," said one casting director. An entertainment lawyer at Fox Rothschild LLP warned the industry, "You just can't compete with someone coming in with fresh money, low overhead and a lot less baggage than you."[5]

Companies in many industries are encountering disruptive innovation because of rapid changes in technology. The digital camera, for instance, virtually eliminated the photographic film industry and the smartphone is doing the same to the compact digital camera.

Innovation, and particularly coping with disruptive innovation, is not easy. Microsoft, while still a technology leader, has had trouble competing with Facebook, Apple, Amazon, and Google in new markets such as e-books, online music, search, and social networking. Moreover, the company struggled to gain traction in the world of mobile computing.[6] CEO Satya Nadella has been quietly transforming Microsoft as it learns from its mistakes, but disruption is always a concern as new technologies emerge.[7] A key ingredient in the success of companies such as Alibaba Group, Domino's, Peloton, Apple, Universal Music Group, and Target is their passion for embracing and creating change. Each year, *Fast Company* publishes a list of the 50 Most Innovative Companies, and these companies all made the 2019 list. The list named the following organizations as the top 10 most innovative companies in the world:[8]

1. Meituan Dianping
2. Grab
3. NBA
4. The Walt Disney Company
5. Stitch Fix
6. Sweetgreen
7. Apeel Sciences
8. Square
9. Oatly
10. Twitch

12.1b Strategic Types of Innovation

Managers can focus on four types of innovation within organizations to achieve strategic advantage. These four types of innovation are summarized in Exhibit 12.2 as technology, products and services, strategy and structure, and culture. The types of innovation are interdependent and changes in one area often require changes in other areas as well.[9] A new product may require changes in the production technology, or a structure innovation may require new employee skills. For example, when Shenandoah Life Insurance Company acquired new digital technology to process claims, the technology was not fully used until clerks were restructured into teams of five to seven members that were compatible with the technology. The structural change was an outgrowth of the technology change. Organizations are interdependent systems, and changing one part often has implications for other parts of the organization.

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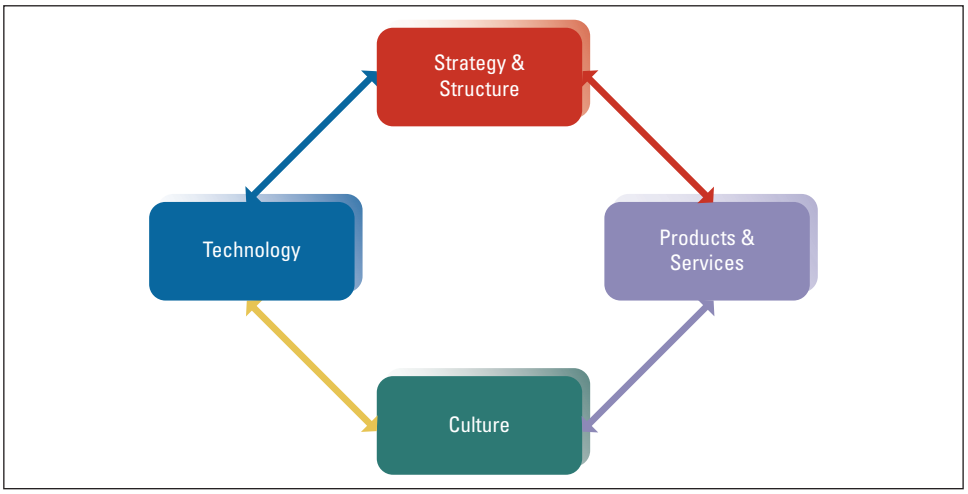

EXHIBIT 12.2
The Four Types of Innovation

Technology innovations are changes in an organization's production process, including its knowledge and skill base, that enable distinctive competence. These changes are designed to make production more efficient or to produce greater volume. Innovations in technology involve the techniques for making products or services. They include work methods, equipment, and workflow. For example, fast-fashion retailer Zara implemented an automated click-and-collect system at its thousands of brick-and-mortar stores to speed customer pickup of online purchases. A customer can order online, then scan or enter a code at the store that will trigger a robot to search for the customer's package and deliver it quickly to a drop box. The new technology improves customer service, as well as bringing more customers into the stores, where they might buy additional items.[10]

Product and service innovations pertain to the product or service outputs of an organization. New products include small adaptations of existing products or entirely new product lines.[11] This chapter's opening example described how the Coca-Cola Company is introducing both new product lines and adaptations of its established products. New products and services are normally designed to increase the market share or to develop new markets, customers, or clients.

Strategy and structure innovations pertain to the administrative domain in an organization. The administrative domain involves the supervision and management of the organization. These innovations include changes in organization structure, strategic management, policies, reward systems, labor relations, coordination devices, management information and control systems, and accounting and budgeting systems. Strategy, structure, and system changes are usually top-down—that is, mandated by top management—whereas product and technology changes often come from the bottom up. Top executives at Apple, for instance, recently shifted the strategy to expand into new industries including financial services with the launch of Apple Card, video streaming with Apple TV+, and online gaming with Apple Arcade.[12] An example of a top-down structure change comes from ICU Medical Inc., where Dr. George Lopez, founder and CEO, made the decision to implement self-directed teams. Even though some managers and employees at first hated the idea, the change proved to be successful in the long run.[13]

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As an organization manager, keep this guideline in mind:

Recognize that the four types of change are interdependent and that changes in one area often require changes in others.

Culture innovations refer to changes in the values, attitudes, expectations, beliefs, abilities, and behavior of employees. Culture innovations pertain to changes in how employees think; these are changes in mindset rather than technology, structure, or products. Former Washington, D.C. Metropolitan Police chief Cathy Lanier changed the culture of the department to focus on preventing crime as much as fighting crime. "We went from beating people up, wrestling them, handcuffing them, to 'How do we prevent these things from happening?'" said Lanier's assistant police chief. Violent crime in Washington, D.C. fell by 23 percent during Lanier's time as chief.[14]

Culture change can be particularly difficult because people don't change their attitudes and beliefs easily. Culture was discussed in detail in the previous chapter, and we will talk more about how to change culture later in this chapter.

REMEMBER THIS

- Many managers prefer to organize day-to-day activities in a predictable, routine manner. However, change—not stability—is the natural order of things in today's global environment. Thus, organizations need to build in change as well as stability, to facilitate innovation as well as efficiency.
- Today's environment creates demands for three types of change—episodic change, continuous change, and disruptive change.
- Disruptive innovation refers to innovations in products and services that typically start small and end up completely replacing an existing product or service technology.
- Four categories of innovation—technology, products and services, strategy and structure, and culture—may give an organization a competitive edge.

12.2 Elements for Successful Change

Regardless of the type or scope of change, there are identifiable stages of innovation, which generally occur as a sequence of events, though innovation stages may overlap.[15] In the research literature on innovation, **organizational change** is considered the adoption of a new idea or behavior by an organization.[16] **Organizational innovation**, in contrast, is the adoption of an idea or behavior that is new to the organization's industry, market, or general environment.[17] The first organization to introduce a new product is considered the innovator, and organizations that copy it are considered to adopt changes. For purposes of managing change, however, the terms *innovation* and *change* will be used interchangeably because the **change process** within organizations tends to be identical, whether a change is early or late with respect to other organizations in the environment. Innovations typically are assimilated into an organization through a series of steps or elements. Organization members first become aware of a possible innovation, evaluate its appropriateness, and then evaluate and choose the idea.[18] The required elements of successful change are summarized in Exhibit 12.3. For a change to be successfully implemented, managers must make sure each element occurs in the organization. If one of the elements is missing, the change process will fail.

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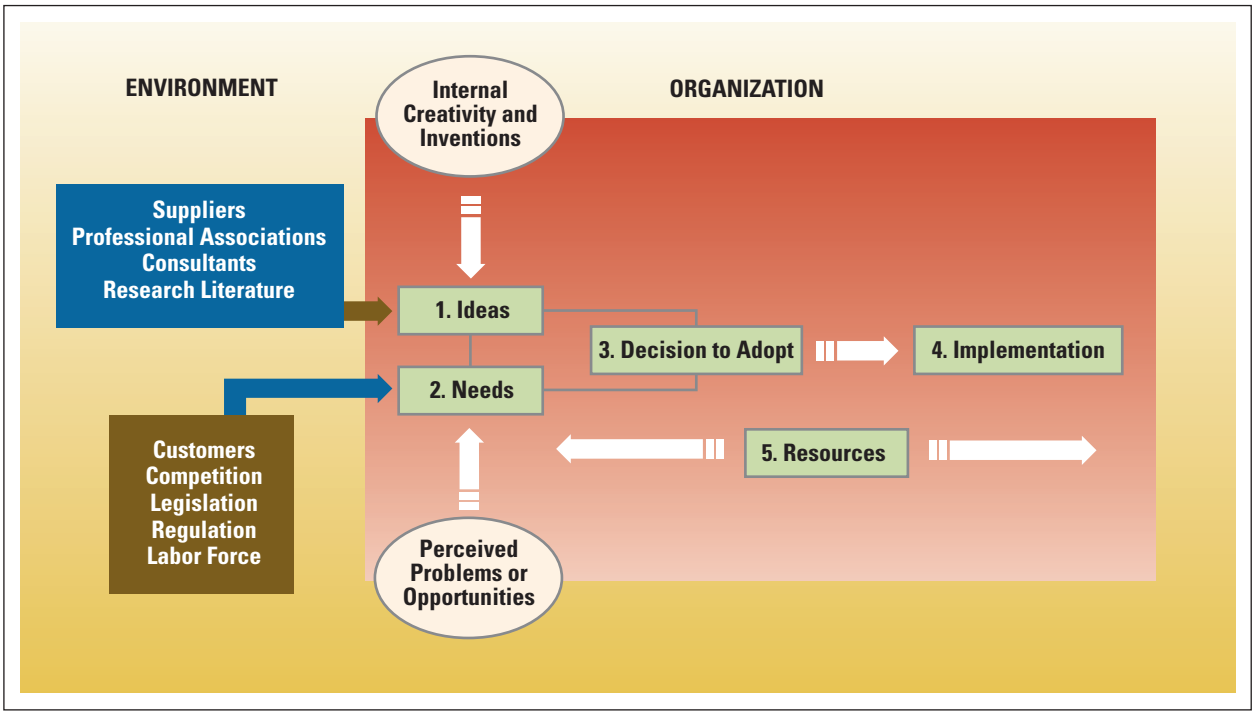
EXHIBIT 12.3
Sequence of Elements for Successful Change



1. *Ideas.* Change is an outward expression of ideas. No company can remain competitive without new ideas.[19] An idea is a new way of doing things. It may be a new product or service, a new management concept, or a new procedure for working together in the organization. Ideas can come from within or from outside the organization. Internal creativity is a dramatic aspect of organizational change. **Creativity** is the generation of novel ideas that may meet perceived needs or respond to opportunities. Under the leadership of director Barbara Jatta, experts at the Vatican Museums are continually experimenting with new ideas to care for priceless artifacts such as the Sistine Chapel with its famous Michelangelo frescoes and works of art by Raphael, Giotto, and others. One idea was to use essential oils rather than toxic synthetic chemicals to protect sculptures and stone works from biological degradation. Vatican scientists are also working on an idea to adapt the product Moss Buster, often used to clean tennis courts, for cleaning and maintaining stone sculptures in the Vatican Gardens.[20] Techniques for spurring internal creativity include increasing the diversity within the organization, making sure employees have plenty of opportunities to interact with people different from themselves, giving people time and freedom for experimentation, and supporting risk-taking and learning.[21] The pharmaceuticals company Eli Lilly holds "failure parties" to commemorate brilliant, efficient scientific work that nevertheless resulted in failure. The company's scientists are encouraged to take risks and look for alternative uses for failed drugs. Lilly's osteoporosis drug Evista was a failed contraceptive. Strattera, which treats attention deficit/hyperactivity disorder, had been unsuccessful as an antidepressant. The blockbuster impotence drug Viagra was originally developed to treat severe heart pain.[22]

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2. *Need.* Ideas are generally not seriously considered unless there is a perceived problem or crisis that provides a need for change. A perceived need for change occurs when managers see a gap between actual performance and desired performance in the organization. Managers try to establish a sense of urgency so that others will understand the need for change. Sometimes a crisis provides an undoubted sense of urgency. Brick-and-mortar retailers are fighting for their lives against Amazon and a host of upstart brands powered by social media, so they are considering all sorts of ideas aimed at getting customers into their physical stores. At the Eddie Bauer store in Columbus, Ohio, for instance, customers can step into the EB Ice Box to test how the company's outdoor gear will perform at 13 degrees Fahrenheit.[23] In many cases there is no crisis, so managers have to recognize a need and communicate it to others.[24] A study of innovativeness in industrial firms, for example, suggests that organizations that encourage close attention to customers and market conditions and actively support entrepreneurial activity produce more ideas and are more innovative.[25]
3. *Decision to adopt.* The decision to adopt occurs when managers or other decision makers choose to go ahead with a proposed idea. Key managers and employees need to be in agreement to support the change. For a major organizational change, the decision might require the signing of a legal document by the board of directors. For a small change, a middle manager or lower-level manager might be authorized to make the decision to adopt an idea.
4. *Implementation.* Implementation occurs when organization members actually use a new idea, technique, or behavior. Materials and equipment may have to be acquired, and workers may have to be trained to use the new idea. Implementation is a very important step because without it, previous steps are to no avail. Implementation of change is often the most difficult part of the change process. Until people use the new idea, no change has actually taken place.
5. *Resources.* Human energy and activity are required to bring about change. Change does not happen on its own; it requires time and resources, for both creating and implementing a new idea. Employees have to provide energy to see both the need and the idea to meet that need. Someone must develop a proposal and provide the time and effort to implement it. Most innovations go beyond ordinary budget allocations and require special funding. Some companies use task forces, as described in Chapter 3, to focus resources on a change. Others set up seed funds or venture funds that employees with promising ideas can tap into. At Eli Lilly, a "blue sky fund" pays researchers for working on projects that don't appear to make immediate commercial sense.[26]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Make sure every change undertaken has a definite need, idea, adoption decision, implementation strategy, and resources. Avoid failure by not proceeding until each element is accounted for.

One point about Exhibit 12.3 is especially important. Needs and ideas are listed simultaneously at the beginning of the change sequence. Either may occur first. Many organizations adopted the computer, for example, because it seemed a promising idea for improving efficiency. The search for a vaccine against the

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HIV virus, on the other hand, was stimulated by a severe need. Whether the need or the idea occurs first, for the change to be accomplished, each of the steps in Exhibit 12.3 must be completed.

REMEMBER THIS

- Organizational change is the adoption of a new idea or behavior by an organization.
- The five required elements of successful change are ideas, needs, the decision to adopt, implementation, and resources.
- For a change to be accomplished, managers must ensure that each of the necessary elements is present.
- Every company needs new ideas. Managers can encourage the generation of novel ideas by increasing diversity, making sure employees have opportunities to interact with people different from themselves, allowing time for experimentation, and supporting risk-taking and learning.

12.3 Technology Innovation

Today, any company that isn't continually developing, acquiring, or adapting new technology will likely be out of business in a few years. Managers can create the conditions to encourage technology innovations. However, organizations face a contradiction when it comes to technology change because the conditions that promote new ideas are not generally the best for implementing those ideas for routine production. An innovative organization is characterized by flexibility and empowered employees and the absence of rigid work rules.[27] As discussed earlier in this book, an organic, free-flowing organization is typically associated with change and is considered the best organization form for adapting to a chaotic environment. Complete the questionnaire in this chapter's "How Do You Fit the Design?" to see if you have characteristics associated with innovativeness.

The flexibility of an organic organization is attributed to people's freedom to be creative and introduce new ideas. Organic organizations encourage a bottom-up innovation process. Ideas bubble up from middle- and lower-level employees because they have the freedom to propose ideas and to experiment. A mechanistic structure, in contrast, stifles innovation with its emphasis on rules and regulations, but it is often the best structure for efficiently producing routine products. The challenge for managers is to create both organic and mechanistic conditions within the organization to achieve both innovation and efficiency. To attain both aspects of technological change, many organizations use an ambidextrous approach.

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HOW DO YOU FIT THE DESIGN?

ARE YOU INNOVATIVE?

Think about your current life. Indicate whether each of the following items is Mostly True or Mostly False for you.

	Mostly True	Mostly False
1. I am always seeking new ways to do things.	_____	_____
2. I consider myself creative and original in my thinking and behavior.	_____	_____
3. I rarely trust new gadgets until I see whether they work for people around me.	_____	_____
4. In a group or at work I am often skeptical of new ideas.	_____	_____
5. I typically buy new foods, gear, and other innovations before other people do.	_____	_____
6. I like to spend time trying out new things.	_____	_____
7. My behavior influences others to try new things.	_____	_____
8. Among my coworkers, I will be among the first to try out a new idea or method.	_____	_____

Scoring: To compute your score on the Personal Innovativeness scale, add the number of Mostly True answers to items 1, 2, 5, 6, 7, and 8 and the Mostly False answers to items 3 and 4.

Interpretation: *Personal Innovativeness* reflects the awareness of a need to innovate and a readiness to try new things. Innovativeness is also thought of as the degree to which a person adopts innovations earlier than other people in the peer group. Innovativeness is considered a positive quality for people in creative companies, creative departments, venture teams, or corporate intrapreneurship. A score of 6–8 indicates that you are very innovative and likely are one of the first people to adopt changes. A score of 4–5 would suggest that you are average or slightly above average in innovativeness compared to others. A score of 0–3 means that you may prefer the tried and trusted, and hence are not excited about new ideas or innovations. As a manager, a high score suggests you will emphasize innovation and change.

Sources: Based on H. Thomas Hurt, Katherine Joseph, and Chester D. Cook, "Scales for the Measurement of Innovativeness," *Human Communication Research* 4, no. 1 (1977), 58–65; and John E. Ettlie and Robert D. O'Keefe, "Innovative Attitudes, Values, and Intentions in Organizations," *Journal of Management Studies* 19, no. 2 (1982), 163–182.

12.3a The Ambidextrous Approach

Recent thinking has refined the idea of organic versus mechanistic structures with respect to innovation creation versus innovation utilization. Organic characteristics such as decentralization and employee freedom are excellent for initiating ideas, but these same conditions often make it hard to implement a change because employees are less likely to comply. Employees can ignore the innovation because of decentralization and a generally loose structure.

How does an organization solve this dilemma? One remedy is for the organization to use an **ambidextrous approach**—to incorporate structures and management processes that are appropriate to both the creation and the implementation of innovation.[28] Ambidexterity has become a hot topic in the field of organizational studies.[29] Another way to think of the ambidextrous approach is to look at the organization design elements that are important for *exploring* new ideas versus the design elements that are most suitable for *exploiting* current capabilities.[30] Exploration means encouraging creativity and developing new ideas, whereas exploitation means implementing those ideas to produce routine products. The organization can be designed to behave in an organic way for exploring new ideas and in a mechanistic way to exploit and use the ideas. Exhibit 12.4 illustrates

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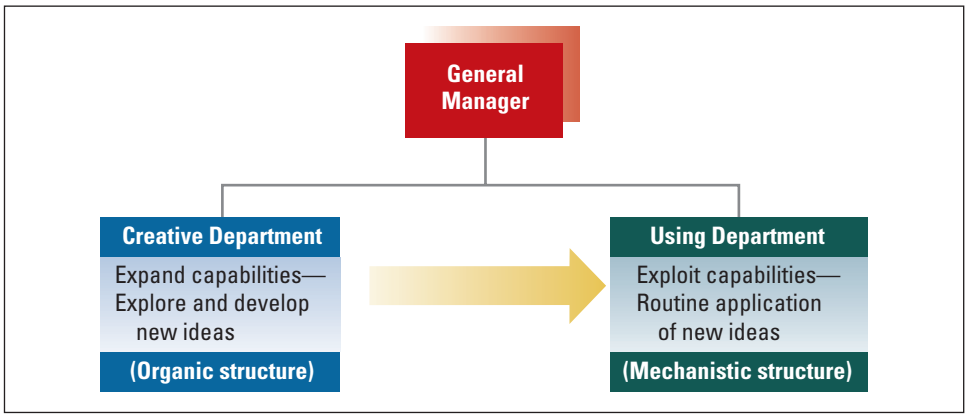

EXHIBIT 12.4
Division of Labor in the Ambidextrous Organization

how one department is structured organically to explore and develop new ideas and another department is structured mechanistically for routine implementation of innovations. Research indicates that organizations that use an ambidextrous approach by designing for both exploration and exploitation perform better and are significantly more successful in launching innovative new products or services.[31]

For example, a study of long-established Japanese companies such as Honda and Canon that have succeeded in breakthrough innovations found that these companies use an ambidextrous approach.[32] To develop ideas related to a new technology, the companies assign teams of young staff members who are not entrenched in the "old way of doing things" to work on the project. The teams are headed by an esteemed elder and are charged with doing whatever is needed to develop new ideas and products, even if it means breaking rules that are important in the larger organization for implementing the new ideas.

A study by Booz & Company (now Strategy&) emphasizes the two parts of the innovation process by looking at what they call *idea generation* and *idea conversion*, which correspond to exploration and exploitation. Idea generation refers to coming up with new ideas for products or services; idea conversion means the efforts to convert those ideas to product development processes. Interestingly, 46 percent of companies in the Booz study saw themselves as doing both stages poorly, and only 25 percent saw themselves as doing both stages well.[33]

12.3b The Bottom-Up Approach

Innovative companies recognize that many useful ideas come from the people who are daily doing the work, serving the customers, fighting off the competition, and figuring out how best to get their jobs done. Thus, companies that want to support innovation implement a variety of mechanisms, systems, and processes that encourage a bottom-up flow of ideas and make sure they get heard and acted upon by top executives.[34] Google's 70/20/10 rule, for example, guides employees to spend 70 percent of their time on assignments from their managers, 20 percent of their time on new ideas that may be peripherally connected to their major projects, and 10 percent of their time on any idea they want to pursue. Google employees are carrying out hundreds of small experiments at any given time.[35] Many successful innovations start with small experiments rather than with grand ideas. Aaron Hall, CEO of Borrego Solar Systems, holds internal "innovation challenge" contests on the company intranet to get his shy, introverted engineers to speak up with their

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BRIEFCASE

As an organization manager, keep these guidelines in mind:

Facilitate frequent changes in internal technology by adopting an organic organizational structure. Give technical personnel freedom to analyze problems and develop solutions or create a separate, organically structured department or venture group to conceive and propose new ideas. Encourage a bottom-up flow of ideas and make sure they get heard and acted upon by management.

ideas for improving the business. Employees vote on their favorites and the winner takes home a cash prize. One idea that was quickly implemented was using software that enables sales and engineering teams to collaborate.[36]

Other companies use an approach sometimes referred to as "innovation communities." At Intuit, managers sponsor Design for Delight (D4D) forums, typically attended by more than 1,000 employees. Two employees who had been at Intuit for only a few months came up with the idea of an online social network for the D4D initiative. In the first year, the network generated 32 ideas that made it to market.[37] Japanese pharmaceutical firm Eisai Company has held more than 400 innovation community forums to focus on specific healthcare-related issues. One idea that is now on the market is technology for dispensing medications in a jelly-like substance that Alzheimer's patients can easily swallow.[38]

Just as important as creating ideas is turning them into action. "There's nothing worse for morale than when employees feel like their ideas go nowhere," says Larry Bennett, a professor of entrepreneurship. At Borrego Solar Systems, the CEO assigns each idea he wants to implement to an executive sponsor, and employees can track the progress of implementation on the intranet.[39]

12.3c Techniques for Encouraging Technology Change

Some specific techniques used by companies to maintain an ambidextrous approach and encourage a bottom-up flow of ideas are switching structures, separate creative departments, venture teams, corporate intrapreneurship, and collaborative teams.

Switching Structures. **Switching structures** means an organization creates an organic structure when such a structure is needed for the initiation of new ideas.[40] Some of the ways organizations have switched structures to achieve the ambidextrous approach are as follows:

- Alphabet (parent company of Google) uses a variety of mechanisms to achieve ambidexterity. Employees in Alphabet's businesses can spend 10 percent of their time working on ideas of their own choosing and many ideas have eventually transformed into successful ventures. Alphabet also created a separate unit, X Development, to explore "moonshot" ideas.[41]
- At Quicken Loans, employees are given four hours each week of focused "bullet time," which is time they can use to explore new ideas and skills outside their regular day-to-day responsibilities. If an employee comes up with a new idea that can be incorporated into the business, implementation occurs within the more mechanistic, regular organization. Routine and precision are important for putting the new ideas into action. One employee used his bullet time to learn app-building skills and helped develop an Alexa-based app for Quicken Loans' online lending platform, Rocket Mortgage.[42]
- The NUMMI plant, a Toyota–GM joint venture in Fremont, California, that operated from 1984 to 2010, created a separate, organically organized, cross-functional subunit, called the Pilot Team, to design production processes for new car and truck models. When the model moved into production, workers returned to their regular jobs on the shop floor.[43]

Each of these organizations found creative ways to be ambidextrous, establishing organic conditions for developing new ideas in the midst of more mechanistic conditions for implementing and using those ideas.

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Creative Departments. In many large organizations the initiation of innovation is assigned to separate **creative departments**.[44] Staff departments such as research and development, engineering, design, and systems analysis create changes for adoption in other departments. Departments that initiate change are organically structured to facilitate the generation of new ideas and techniques. Departments that use those innovations tend to have a mechanistic structure more suitable for efficient production.

One example of a creative department is the Lowe's Innovation Lab, where research employees work with outside organizations such as Google and Microsoft to come up with technological innovations to improve operations and customer service at Lowe's stores. LoweBots, for instance, are self-guided robots that can check inventory for employees or guide customers to the products they are looking for. Other innovations, including a robotic suit to give employees superhuman strength for lifting heavy objects and a Holoroom How-To virtual reality tool for customers, are being tested in Lowe's stores. At Otsuka Pharmaceutical Company, president Tatsuo Higuchi says its research labs "put a high value on weird people" to get the kind of creative spirit that is willing to try new things and look for the unexpected.[45] However, in the department that manufactures drugs, where routine and precision are important, a pharmaceutical company would prefer to have less-unusual people who are comfortable following rules and standard procedures.

Another type of creative department is the **idea incubator**, an increasingly popular way to facilitate the development of new ideas within the organization. An idea incubator provides a safe harbor where ideas from employees throughout the organization can be developed without interference from company bureaucracy or politics.[46] Companies as diverse as Boeing, Adobe Systems, Yahoo!, Ziff-Davis, and UPS are using incubators to support the development of creative ideas.

Venture Teams. **Venture teams** are a technique used to give free rein to creativity within organizations. Venture teams are often given a separate location and facilities so they are not constrained by organizational procedures. A venture team is like a small company within a large company. Numerous organizations have used the venture team concept to free creative people from the bureaucracy of a large corporation.[47] Phillip Honovich planned to work for a young, small company after graduating from college but he found the same freedom and excitement working for a venture team at the 50-year-old giant corporation MasterCard, where he helped develop the ShopThis platform that lets people buy products directly from a digital magazine page without leaving the page. The company has around 10,000 employees working in dozens of venture teams. "It feels just like a startup," Honovich said. Other large companies, including GE, Coca-Cola, and Mondelez, have created in-house venture teams in recent years to encourage innovation.[48]

One type of venture team is called a *skunkworks*.[49] A **skunkworks** is a separate, small, informal, highly autonomous, and often secretive group that focuses on breakthrough ideas for the business. The original skunkworks was created by Lockheed Martin more than 50 years ago and is still in operation. The essence of a skunkworks is that highly talented people are given the time and freedom to let creativity reign. X Development is a semi-secret research lab that was founded by Google in 2010 and now operates as a division of Alphabet. It started with the development of Google's self-driving car and now operates in an undisclosed location where engineers work on shoot-for-the-moon ideas, or as the X website states, "radical new technologies to solve some of the world's hardest problems." Projects include Project Loon, exploring how balloons can deliver the Internet to extremely rural locations, and Makani, which focuses on using kites to generate renewable

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electricity. This skunkworks was once so secretive that until *The New York Times* wrote about it several years ago, even many of Google's employees didn't know it existed.[50]

A variation of the venture team concept is the **new-venture fund**, which provides financial resources for employees to develop new ideas, products, or businesses. Royal Dutch Shell puts 10 percent of its R&D budget into the GameChanger program, which provides seed money for innovation projects that are highly ambitious, radical, or long term and would get lost in the larger product development system. Tyson Foods recently set up a new-venture fund to support projects such as developing plant-based meat alternatives or creating packaging that helps reduce food spoilage.[51]

Corporate Intrapreneurship. Corporate intrapreneurship attempts to develop an internal entrepreneurial spirit, philosophy, and structure that will produce a higher-than-average number of innovations. Corporate intrapreneurship may involve the use of creative departments and new-venture teams, but it also attempts to release the creative energy of all employees in the organization. The most successful companies over the long term are ones in which innovation is an everyday way of thinking, an ongoing process rather than a one-time event.[52] This chapter's BookMark describes some lessons from Pixar for how to keep people's creative juices flowing.

BOOKMARK 12.0 HAVE YOU READ THIS BOOK?

Creativity, Inc.: Overcoming the Unseen Forces That Stand in the Way of True Inspiration

By Ed Catmull

Pixar Animation Studios has put out some amazingly successful films. It is also an amazingly successful business. Moreover, Pixar's leaders have been credited with reinvigorating Disney Animation Studios, which was on its last legs when Pixar was bought by Disney in 2006. The management philosophy at Pixar, and now at Disney Animation Studios, is a radical one: let the creative people have creative control, and financial success will follow. Ed Catmull, former president and one of the co-founders of Pixar, wrote *Creativity, Inc.* not only to explain how Pixar produced 14 box office hits in a row, but how any company can reboot employees' creative energy.

THE SOURCES OF PIXAR'S MAGIC

The book gives numerous tips for how to manage and motivate a creative workforce, based on what Catmull learned from his experiences at Pixar.

- *Embrace New Experiences*. When Catmull was first recruited by George Lucas to work special effects images into live-action footage, the film editors at Lucasfilm resisted working with a computer. Only when John Lasseter was hired and brought his enthusiastic emphasis on storytelling to the organization did people begin to have a shift in mindset. To prevent the risk-averse repackaging of what worked well before, for example, teams do field research before every film. For *Ratatouille,* the film about a Parisian rat who wants to be a chef, a team went to Paris to eat, visit kitchens, talk to chefs, and even slosh through the Paris sewer system.
- *Encourage Everyone to Speak with Candor*. "A hallmark of a creative culture is that people feel free to share ideas, opinions, and criticisms," Catmull writes. Pixar's primary mechanism for ensuring candor is the Braintrust, a group of creative people who meet every few months and are expected to say whatever they think. No one has any authority, and the director isn't obligated to follow any suggestions, but the results of putting smart, creative people together and encouraging them to speak candidly can be phenomenal. "Candor could not be more crucial to our creative process. Why? Because early on, all of our movies suck," Catmull writes. Pixar dares to attempt movies about talking toys, rats preparing food, and other off-the-wall themes, but it almost never gets them right on the first pass.
- *Give Everyone a Voice*. Pixar is focused on protecting creative people and giving them the autonomy they need to create. However, Catmull learned after *Toy Story* came out that the production managers had been very unhappy working on the film and were reluctant to sign up for the next one. This could

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seriously hurt the company. Catmull discovered that the production people felt that they were treated like second-class citizens by the artists. Surprised because no one had taken advantage of the "open door policy" to complain during filming, he called everyone together and said that anyone should feel free to talk to anyone else at any time, without fear of embarrassment or reprimand. "People talking directly to one another, then letting the manager find out later, was more efficient than trying to make sure that everything happened in the 'right' order and through the 'proper' channels," Catmull writes.

WHAT IS THE ROLE OF THE LEADER?

Leaders can miss a lot, Catmull says. It is partly because they are so busy, but also because everyone has blind spots that become more pronounced as they move higher in power and prestige. Leaders can't totally avoid this, he says, but they can be aware of it and remember that there is so much that they don't know. "The better approach," he says, "is to accept that we can't understand every facet of a complex environment and to focus, instead, on techniques to deal with combining different viewpoints."

Creativity, Inc., by Ed Catmull, is published by Random House.

An important outcome of corporate intrapreneurship is to facilitate **idea champions**. These go by a variety of names, including *advocate*, *intrapreneur,* or *change agent*. Idea champions provide the time and energy to make things happen. They fight to overcome natural resistance to change and to convince others of the merit of a new idea.[53] Some companies use the results of a social network analysis, as described in Chapter 9, to pinpoint people who might have influence over colleagues and can help implement a new idea. HealthFitness Corporation, which provides corporate health services, for example, had invested $30 million in a new technology platform. Client expectations were high, but some employees weren't on board with the new idea. Managers identified 30 or so people with high influence and gave them extra insight into the project. With these people supporting the project and building positive buzz, the project was implemented much more smoothly.[54]

The importance of the idea champion is illustrated by a fascinating fact discovered by Texas Instruments: when TI reviewed 50 successful and unsuccessful technical projects, it discovered that every failure was characterized by the absence of a volunteer champion. There was no one who passionately believed in the idea, who pushed the idea through every obstacle to make it work. TI took this finding so seriously that now its number-one criterion for approving new technical projects is the presence of a zealous champion.[55] Similarly, at SRI International, a contract research and development firm, managers use the saying "no champion, no product, no exception."[56] Research confirms that successful new ideas are generally those that are backed by someone who believes in the idea wholeheartedly and is determined to convince others of its value. Numerous studies support the importance of idea champions as a factor in the success of new products.[57]

Companies encourage idea champions by providing freedom and slack time to creative people. Many highly innovative companies allow employees to develop new technologies without company approval. Sometimes referred to as *bootlegging,* the unauthorized research often pays big dividends. For example, innovation leader 3M launches an average of 20 new products *every week,* some of which result from employee bootlegging.[58]

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ASSESS YOUR ANSWER

1 The most important aspect for creating an innovative company is requiring people to come up with new ideas.

ANSWER: *Disagree.* New ideas are essential for innovation, but managers can't simply issue directives ordering people to come up with new ideas. Managers create the conditions that are conducive to both the creation of new ideas and their implementation. Organizing to sustain innovation is as important as organizing to spur creativity.

REMEMBER THIS

- For technology innovation, which is of concern to most organizations, an ambidextrous design that encourages both employee creative exploration and efficient exploitation of new ideas often works to sustain a flow of new ideas and put them into practice.
- Other approaches are to establish a separate department charged with creating new technical ideas, establish venture teams or idea incubators, apply a variety of mechanisms, systems, and processes that encourage a bottom-up flow of ideas and make sure they get heard and acted upon by top executives, and encourage idea champions.

12.4 New Products and Services

Although the concepts just discussed are important to product and service as well as technology changes, other factors also need to be considered. In many ways, new products and services are a special case of innovation because they are used by customers outside the organization. Since new products are designed for sale in the environment, uncertainty about the suitability and success of an innovation is very high. Elkay Manufacturing Company took a chance on introducing an adaptation of an existing product based on observation of customers.

IN PRACTICE

Elkay Manufacturing

You probably remember it from school. There might be one outside your classroom right now: the water fountain. It hadn't changed much for decades. Then, a few years ago, managers at Elkay Manufacturing started noticing what they call "the airport dance": people doing a shuffle as they tried to tilt their bottles at the right angle to fill them at the water fountain without splashing water all over themselves.

Elkay began redesigning the water fountain to create a "bottle filling station" instead. About half of the water people consume these days comes from taps, including drinking fountains. Elkay managers wanted a fountain where people could fill their bottles without ever even touching the fountain, to avoid the concern many people have about germs.

Charles Stirling/Alamy Stock Photo

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Moreover, they thought filling a 16-ounce bottle should take less than 10 seconds. Early in the project, one engineer said that wasn't possible. Another engineer, who joined Elkay from an auto parts company, found a way to speed up the flow. The result was a machine that fills a 16-ounce bottle in about five seconds if the water is at room temperature, or a few seconds longer if it goes through refrigeration pipes. The traditional water fountain needed at least 20 seconds.

The addition of a digital counter on Elkay's first EZH20 model ended up helping "make this thing go viral," said one manager who had originally thought the digital counter was a dumb idea. College students liked tracking how many plastic bottles were being kept out of landfills. Some held intra-campus competitions to see who could reuse the most bottles. Incoming freshmen at Muhlenberg College in Allentown, Pennsylvania, which has installed 49 of the new EZH20 stations, receive a free stainless steel water bottle. The college says sales of bottled water have fallen 90 percent. Students say that's at least 1.4 million plastic bottles that have been kept out of landfills.[59]

Other companies have also introduced new types of water fountains designed to fill water bottles. Elkay says its new fountains have been installed in hundreds of colleges and universities and at least 15 airports including Chicago's O'Hare and New York's LaGuardia.

12.4a New Product Success Rate

Research has explored the enormous uncertainty associated with the development and sale of new products.[60] To understand what this uncertainty can mean to organizations, consider that Microsoft spent two years and hundreds of millions of dollars creating a new line of smartphones, called Kin One and Kin Two, and then pulled them from the market after less than two months because no one was buying. Even Google and its parent company Alphabet have struggled with new product development. After spending several years developing a customizable smartphone with interchangeable parts, Alphabet dropped the project in late 2016 because the product proved too difficult to move beyond prototypes. Google's previous launch of Nexus Q, a black ball meant to stream video and music, was plagued by development delays and customers who had already ordered it received it free because it was deemed to be too expensive for the benefits. CNN named it one of the top 10 "tech fails" of 2012.[61] And remember Zune, Microsoft's music player designed to compete with the iPod? If you don't, that's fine; neither does anyone else.[62]

Products from companies in other industries can suffer the same fate. Coca-Cola invested $50 million in an advertising campaign for C2, a new cola that had half the calories and carbs but (supposedly) all the taste of regular Coke and was aimed at a market of 20- to 40-year-old men. The benefits weren't distinctive enough and the product flopped. P&G introduced a new product called "Scentstories" that looked like a CD player and emitted an air freshener every 30 minutes. Consumers were confused by the product and the marketing messages, thinking the product involved both music and scent.[63] McDonald's Arch Deluxe hamburger, designed to appeal to "adult tastes," flopped despite millions invested in research and development and a $100 million advertising campaign.[64] Developing and producing products that fail is a part of business in all industries. Toy companies introduce thousands of new products a year, and many of them fail. U.S. food companies put approximately 5,000 new products in supermarkets each year, but the failure rate of new food products is 70 to 80 percent.[65] Organizations take the risk because product innovation is one of the most important ways companies adapt to changes in markets, technologies, and competition.[66]

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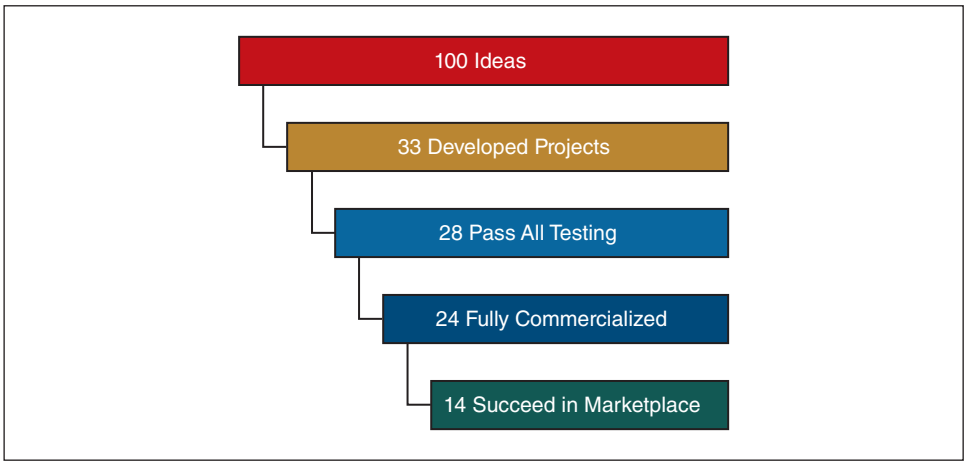
EXHIBIT 12.5
New Product Success Rates



Source: Based on Marjorie Adams and the Product Development and Management Association, "Comparative Performance Assessment Study 2004," available for purchase at http://www.pdma.org (search on CPAS). Results reported in Jeff Cope, "Lessons Learned—Commercialization Success Rates: A Brief Review," *RTI Tech Ventures* newsletter 4, no. 4 (December 2007).

Although measuring the success of new products is tricky, a survey by the Product Development and Management Association (PDMA) sheds some light on the commercialization success rates of new products across a variety of industries.[67] PDMA compiled survey results from over 400 PDMA members. The findings about success rates are shown in Exhibit 12.5. On the average, only 28 percent of all projects undertaken in the R&D laboratories passed the testing stage, which means all technical problems were solved and the projects moved on to production. Less than one-fourth of all product ideas (24 percent) were fully marketed and commercialized, and only 14 percent achieved economic success.[68]

12.4b Reasons for New Product Success

The next question to be considered is: why are some products more successful than others? Research at the Massachusetts Institute of Technology (MIT) suggests that keeping research and manufacturing close together helps companies be more innovative and more successful with their innovations. GE custom-built a large manufacturing facility in upstate New York to be near its research campus, where a new secret battery technology was being invented. The idea was to knit together design, prototyping, manufacturing, testing, and production for uses of the new battery technology.[69] Other studies indicate that innovation success is related to collaboration between technical and marketing departments. Successful new products and services seem to be technologically sound and also carefully tailored to customer needs.[70] A study called Project SAPPHO examined 17 pairs of new product innovations, with one success and one failure in each pair, and concluded the following:

1. Successful innovating companies had a much better understanding of customer needs and paid much more attention to marketing.
2. Successful innovating companies made more effective use of outside technology and outside advice, even though they did more work in-house.
3. Top management support in the successful innovating companies was from people who were more senior and had greater authority.

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Thus, there is a distinct pattern of tailoring innovations to customer needs, making effective use of technology, and having influential top managers support the project. These ideas taken together indicate that effective design for new product innovation is associated with horizontal coordination across departments.

12.4c Horizontal Coordination Model

The organization design for achieving new product innovation involves three components—departmental specialization, boundary spanning, and horizontal coordination. These components are similar to the horizontal coordination mechanisms discussed in Chapter 3, such as teams, task forces, and project managers, and the differentiation and integration ideas discussed in Chapter 4. Exhibit 12.6 illustrates these components in the **horizontal coordination model**.

Specialization. The key departments in new product development are R&D, marketing, and production. The specialization component means that the personnel in all three of these departments are highly competent at their own tasks. The three departments are differentiated from each other and have skills, goals, and attitudes appropriate for their specialized functions.

Boundary Spanning. This component means each department involved with new products has excellent linkage with relevant sectors in the external environment. R&D personnel are linked to professional associations and to colleagues in other R&D departments. They are aware of recent scientific developments. Marketing personnel are closely linked to customer needs. They listen to what customers have to say, and they analyze competitor products and suggestions by distributors. One study compared companies with good product development track records to those with poor track records and found that the best performers keep in close touch with customers throughout the product development process and carefully research what customers want and need.[71] Kimberly-Clark had amazing success with Huggies Pull-Ups because marketing researchers worked closely with customers in their own homes and recognized the emotional appeal of pull-on diapers for toddlers. By the time competitors caught on, Kimberly-Clark was selling $400 million worth of Huggies annually.[72] Procter & Gamble's product development teams conduct "transaction learning experiments," whereby they produce and sell small quantities of a new product online, at mall kiosks, and at amusement parks to gauge customer interest, thus letting consumers "vote with their wallets" on the desirability of a new product.[73]

Horizontal Coordination. This component means that technical, marketing, and production people share ideas and information. Research people inform marketing of new technical developments to learn whether the developments are applicable to customers. Marketing people provide customer complaints and information to R&D to use in the design of new products. People from both R&D and marketing coordinate with production because new products have to fit within production capabilities so costs are not exorbitant. The decision to launch a new product is ultimately a joint decision among all three departments. At Avocent, an information technology management company, managers redesigned the product development process so that programmers, testers, and customers work on the same team and follow a project from start to finish. After a spate of quality and safety issues and the recall of millions of vehicles, Toyota revamped its process for developing new

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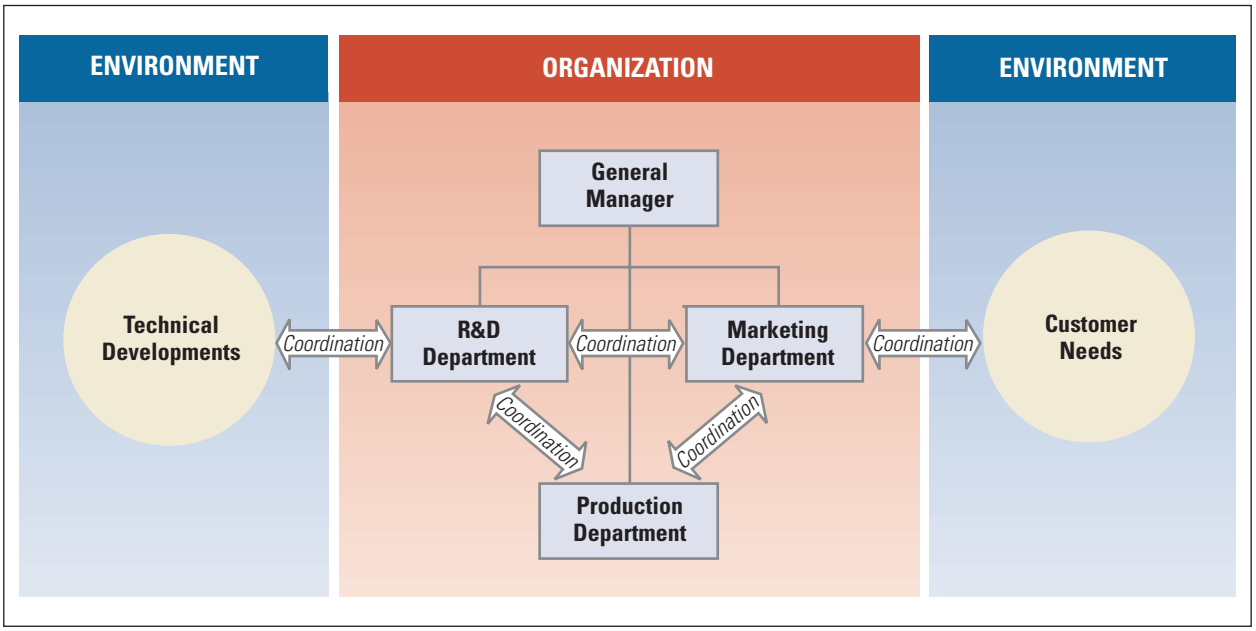
EXHIBIT 12.6
Horizontal Coordination Model for New Product Innovations



cars to increase communication across departments.[74] Horizontal coordination, using mechanisms such as cross-functional teams, increases both the amount and the variety of information for new product development, enabling the design of products that meet customer needs and circumventing manufacturing, quality, and marketing problems.[75] Corning used a horizontal linkage model to create a new product for the mobile phone industry.

IN PRACTICE
Corning, Inc.

If you have ever had a mobile phone with a plastic screen, you probably know that the plastic can scratch and even break easily. A small team in Corning's specialty materials division spotted an opportunity. They began looking for a way that mobile phone displays could be made out of a super-strong but flexible glass that the company had originally attempted (unsuccessfully) to sell for automobile windshields in the 1960s. Just producing an experimental batch to gauge customer interest would cost as much as $300,000, but managers took the risk because the project had a strong idea champion.

Once the test run was completed and potential customers expressed excitement, managers had to move quickly. Corning took the project from concept to commercial success in an amazingly short period of time. One reason is that the company had both the right culture and the right systems. Corning divisions and departments know that top managers expect, support, and reward collaboration on promising new product launches. Innovation at Corning is managed not by lone inventors or small teams in silos, but rather by multidisciplinary groups all across the organization. Thus, employees from R&D, manufacturing, and sales quickly agreed to serve on the team developing the new glass product, which was eventually named Gorilla Glass.

Corning continued to improve the product, with the Gorilla Glass 6 version released in 2018. "Every time we would come up with something, it would be the best we could do at that point, and then we'd have to top ourselves," said John Mauro, who worked on early versions of the product. By 2018, Corning's Gorilla Glass was on more than 6 billion consumer devices worldwide, including every iPhone and Android flagship phone sold.[76]

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By using a horizontal linkage model for new product development, Corning has been highly effective in taking products from idea to success in the marketplace. Famous innovation failures—such as New Coke, Microsoft's Zune music player, and the U.S. Mint's Susan B. Anthony dollar—usually violate the horizontal linkage model. Employees fail to connect with customer needs and market forces, or internal departments fail to adequately share needs and coordinate with one another. Research has confirmed a connection between effective boundary spanning that keeps the organization in touch with market forces, smooth coordination among departments, and successful product development.[77]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Encourage marketing, research, and production departments to develop linkages to each other and to their environments when new products or services are needed. Consider bringing customers, suppliers, and others from outside the boundaries of the organization into the product development process.

12.4d Open Innovation and Crowdsourcing

Many successful companies include customers, strategic partners, suppliers, and other outsiders directly in the product and service development process. One of the hottest trends is *open innovation*.[78]

In the past, most businesses generated their own ideas in-house and then developed, manufactured, marketed, and distributed them, which represents a closed innovation approach. Today, though, forward-looking companies are trying a different method. **Open innovation** means extending the search for and commercialization of new products beyond the boundaries of the organization and even beyond the boundaries of the industry.[79] For example, Procter & Gamble wanted to introduce a new version of its successful snack food Pringles, with trivia questions, facts, and jokes printed on the chips. P&G reached out to its global networks of individuals and organizations and found the owner of a small bakery in Bologna, Italy, who had developed an ink-jet process for printing edible images on cakes and cookies. P&G quickly adapted the process for use on Pringles, and the innovation helped the North American Pringles business achieve double-digit growth.[80] Game maker Rovio extended the commercialization of the Angry Birds brand into books, movies, and toys by letting outsiders license the popular gaming app.[81] Collaboration with other firms and with customers and other outsiders provides many benefits, including faster time to market, lower product development costs, improved quality, and better adaptation of products to customer needs. It can also stimulate stronger internal coordination across departments. Because open innovation requires the involvement of people from different areas of the company, it forces managers to set up stronger internal coordination and knowledge-sharing mechanisms.[82]

One research project found that firms with robust open innovation capabilities are seven times more effective in terms of generating returns on their overall research and development investment than firms with weak capabilities.[83] Consumer products giant P&G is one of the best-known proponents of open innovation. Some of the company's best-selling products, including the Swiffer SweeperVac, Olay Regenerist, and Mr. Clean Magic Eraser, were developed in whole or in part by someone outside the company. P&G gets more than 50 percent of its innovation from outside company walls.[84]

The Internet has made it possible for companies such as P&G, Eli Lilly, IBM, and GE to tap into ideas from around the world and let hundreds of thousands of people contribute to the innovation process. The approach to open innovation that solicits ideas, services, or information from online volunteers rather than from traditional employees is referred to as **crowdsourcing**.[85] The most straightforward way to enlist the help of a crowd is with a contest.[86] Elastec/American Marine, based in Carmi, Illinois, won a $1 million prize for a new oil recovery system that

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can recover oil from the ocean's surface at a rate of 4,600 gallons a minute, more than four times the industry standard.[87] Rob McEwen, the chairman and CEO of Canadian mining group Goldcorp, created the Goldcorp Challenge, putting Red Lake's previously closely guarded topographic data online and offering $575,000 in prize money to anyone who could identify rich drill sites. More than 1,400 technical experts in 50 countries offered alternatives to the problem, and two teams working together in Australia pinpointed locations that have made Red Lake one of the world's richest gold mines.[88] There has been a surge of interest in Internet-based innovation contests over the past few years, giving companies a chance to integrate external with internal input into the front end of new product development.[89]

ASSESS YOUR ANSWER

2 Asking customers what they want is the best way to create new products that will be successful in the marketplace.

ANSWER: *Agree or disagree.* It depends on the organization. Bringing customers into the product development process has been highly beneficial for many companies. However, many products developed based on what customers say they want do not succeed. In addition, some highly innovative companies, like Apple, believe relying too much on customer input limits the pie-in-the-sky thinking needed to create truly breakthrough products.

12.4e The Need for Speed

The rapid development of new products and services can be a strategic weapon in an ever-shifting global marketplace.[90] In general, faster new product development is associated with lower development costs and greater success because firms can gain favorable market position, more readily adapt to changing environments, and quickly address shifting consumer demands.[91]

Large toy companies like Mattel and Hasbro are trying to slash development and production times to compete with smaller companies that can respond more quickly to fast-moving trends, which "burn really bright and really short," as Josh Loerzel, vice president of sales for toy company Zing, puts it. Hasbro set up a small team called Quick Strike to turn social media trends into new products. One result, a game called Speak Out inspired by an online video where people tried to pronounce phrases with dental mouthguards in their mouths, took just 11 weeks to develop.[92] In the fashion retail industry, Lord & Taylor adjusted its supply chain relationships to get fast-selling items in the stores quicker. An Isaac Mizrahi top that sold out only days after hitting the stores was back in stock within six weeks rather than the nine months it used to take. Other companies like J. C. Penney and Gap are also striving to imitate the fast-fashion approach of Inditex SA's Zara. Zara gets new styles into stores twice a week and can take a new item from the design workshop in Spain to a sales rack in Manhattan in less than a month.[93]

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REMEMBER THIS

- New products and services generally require cooperation among several departments, so companies use a horizontal coordination model for new product innovation.
- The horizontal coordination model involves three components—departmental specialization, boundary spanning, and horizontal linkages.
- A recent trend is open innovation, which brings customers, suppliers, and other outsiders directly into the search for and development of new products.
- Crowdsourcing is a growing part of the open innovation trend.
- Speedy development of new products and services can be a strategic weapon in today's environment, especially for companies in industries such as toys and fashion, where trends change quickly.

12.5 Strategy and Structure Change

The preceding discussion focused on new production processes and products, which are based in the technology of an organization. The expertise for such innovation lies within the technical core and professional staff groups, such as research and engineering. This section turns to an examination of strategy and structure changes.

All organizations need to make changes in their strategies, structures, management processes, and administrative procedures from time to time. In the past, when the environment was relatively stable, most organizations focused on small, incremental changes to solve immediate problems or take advantage of new opportunities. However, over the past couple of decades, companies throughout the world have faced the need to make radical changes in strategy, structure, and management processes to adapt to new competitive demands.[94]

Many organizations are cutting layers of management and decentralizing decision making. Fifteen or so years ago, toy maker LEGO was a hierarchical organization, "with the big dogs at the peak of the pyramid" making all the decisions. But this was a do or die survival period for the company, and some top leaders felt a new structural approach was needed. They flipped the top-down approach by defining the outcomes they wanted and giving teams almost complete freedom to set their own targets and make decisions about innovation. When Ninjago: Masters of Spinjitzu launched in January of 2011, it set new financial records for LEGO, proving the success of the decentralized model.[95] LEGO's decentralized approach has also successfully launched several widely-acclaimed films, such as *The Lego Movie*, *The Lego Batman Movie*, and *The Billion Brick Race*.

There is a strong shift within organizations toward more decentralized and horizontal structures, with teams of front-line employees empowered to make decisions and solve problems on their own. Some companies are breaking totally away from traditional organization forms and shifting toward virtual network strategies and structures. Numerous companies reorganized and shifted their strategies to incorporate e-business. These types of changes are the responsibility of the organization's top managers, and the overall process of change is typically different from the process for innovation in technology or new products.

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12.5a The Dual-Core Approach

The **dual-core approach** to organizational change compares management and technical innovation. **Management innovation** refers to the adoption and implementation of a management practice, process, structure, strategy, or technique that is new to the organization and is intended to further organizational goals.[96] This type of change pertains to the design and structure of the organization itself, including restructuring, downsizing, teams, control systems, information systems, and departmental grouping. The implementation of a balanced scorecard, as described in Chapter 11, for example, would be a management innovation, as would the establishment of a joint venture for global expansion, as described in Chapter 6, or the shift to a virtual network organization structure, described in Chapter 3.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Facilitate changes in strategy and structure by adopting a top-down approach. Use a mechanistic structure when the organization needs to adopt frequent management changes in a top-down fashion.

Research into management change suggests two things. First, management changes occur less frequently than do technical changes. Second, management changes occur in response to different environmental sectors and follow a different internal process than do technology-based changes.[97] The dual-core approach to organizational change identifies the unique processes associated with management change.[98] Organizations—schools, hospitals, city governments, welfare agencies, government bureaucracies, and many business firms—can be conceptualized as having two cores: a *technical core* and a *management core*. Each core has its own employees, tasks, and environmental domain. Innovation can originate in either core.

The management core is above the technical core in the hierarchy. The responsibility of the management core includes the structure, control, and coordination of the organization itself and concerns the environmental sectors of government, financial resources, economic conditions, human resources, and competitors. The technical core is concerned with the transformation of raw materials into organizational products and services and involves the environmental sectors of customers and technology.[99]

The point of the dual-core approach is that many organizations—especially nonprofit and government organizations—must adopt frequent management changes and need to be structured differently from organizations that rely on frequent technical and product changes for competitive advantage.

12.5b Organization Design for Implementing New Management Processes

The findings from research comparing management and technical change suggest that a mechanistic organization structure is appropriate for frequent management changes, including changes in goals, strategy, structure, control systems, and human resources.[100] Organizations that successfully adopt many management changes often have a larger administrative ratio, are larger in size, and are centralized and formalized compared with organizations that adopt many technical changes.[101] The reason is the top-down implementation of changes in response to changes in the government, financial, or legal sectors of the environment. If an organization has an organic structure, lower-level employees have more freedom and autonomy and, hence, may resist top-down initiatives.

The innovation approaches associated with management versus technical change are summarized in Exhibit 12.7. Technical change, such as changes in production techniques and innovative technology for new products, is facilitated by an organic structure, which allows ideas to bubble upward from lower- and middle-level

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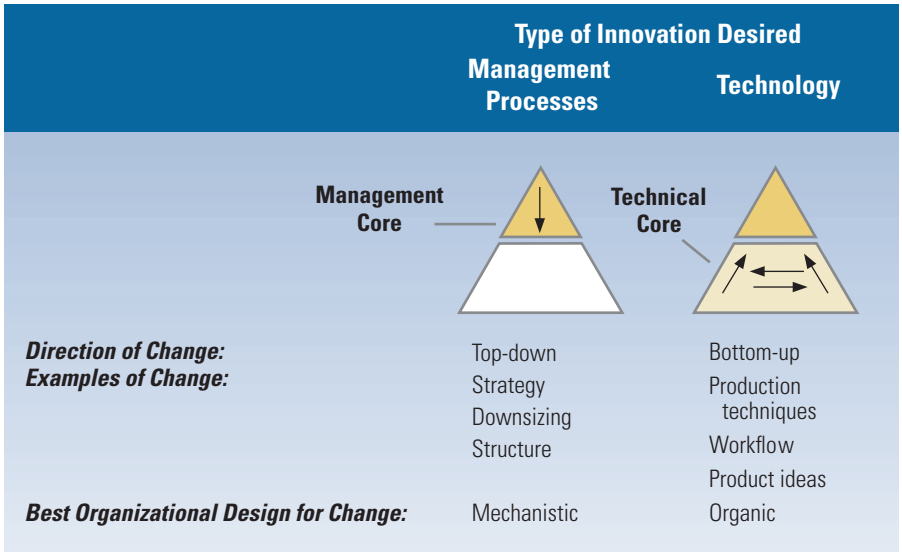

EXHIBIT 12.7
Dual-Core Approach to Organization Change

employees. Organizations that must adopt frequent management changes, in contrast, tend to use a top-down process and a mechanistic structure. For example, changes such as implementation of Six Sigma methods, application of the balanced scorecard, decentralization of decision making, or downsizing and restructuring are facilitated by a top-down approach.

Research into civil service reform found that the implementation of management innovation was extremely difficult in organizations that had an organic technical core. The professional employees in a decentralized agency could resist civil service changes. By contrast, organizations that were considered more bureaucratic and mechanistic in the sense of high formalization and centralization adopted management changes readily.[102]

What about business organizations that are normally technologically innovative in bottom-up fashion but suddenly face a crisis and need to reorganize? Or a technically innovative, high-tech firm that must reorganize frequently to accommodate changes in production technology or the environment? Technically innovative firms may suddenly have to restructure, reduce the number of employees, alter pay systems, disband teams, or form a new division.[103] The answer is to use a top-down change process. The authority for strategy and structure change lies with top management, who should initiate and implement the new strategy and structure to meet environmental circumstances. For example, to address increasing complexity in the oil and gas technology industry, top leaders at FMC Subsea, a division of global technology firm FMC Technologies (now TechnipFMC) implemented two major structural changes between 2011 and 2016 aimed at increasing horizontal coordination across global units. An example of strategy change comes from J. Crew, where a new CEO lowered prices, began offering extended women's sizes up to size 24, and began incorporating more artisanal products and vintage designs.[104] For structure and strategy changes such as these, employee input may be sought, but top managers have the responsibility to direct the change. Top managers at pharmaceutical company GlaxoSmithKline implemented top-down change to improve drug discovery.

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IN PRACTICE

GlaxoSmith-Kline

Large pharmaceutical companies such as Pfizer, AstraZeneca, and GlaxoSmithKline have grown even larger over the past decade or so through mergers and acquisitions. The increasing size brought power in sales and marketing, but the growing bureaucracy hampered research and development efforts.

The CEO of GlaxoSmithKline decided to try an experimental approach that would get his R&D scientists thinking and acting more like those in biotechnology startups. He broke the R&D unit into small groups of 20 to 60 people, called Discovery Performance Units (DPUs). Each group had scientists from all disciplines working together and focusing their combined expertise on finding new drugs for specific types of diseases, such as cancer or autoimmune diseases. Previously, chemist David Wilson says he could go days on end without ever seeing a biologist. Now, he says, the mix of disciplines has led to quick decisions and productive brainstorming.[105]

Most researchers at Glaxo welcomed the creation of the DPUs. Implementing the new R&D approach spurred an entrepreneurial drive and gave people a chance to focus their energies on the most promising areas of research. If the units don't perform as needed to help the company discover cutting-edge drugs, top managers may have to implement more difficult top-down changes by terminating employees and outsourcing more R&D work.

Top-down changes related to restructuring and downsizing can be painful for employees, so top managers should move quickly and authoritatively to make them as humane as possible.[106] A study of successful corporate transformations, which frequently involve painful changes, found that managers followed a fast, focused approach. When top managers spread difficult changes such as downsizing over a long time period, employee morale suffers and the change is much less likely to lead to positive outcomes.[107]

Top managers should also remember that top-down change means initiation of the idea occurs at upper levels and is implemented downward. It does not mean that lower-level employees are not educated about the change or allowed to participate in it.

REMEMBER THIS

- The dual core approach contrasts management and technical innovation. Management changes occur less frequently than do technical changes, they occur in response to different environmental sectors, and they follow a different internal process than do technical changes.
- Strategy and structure innovations are in the domain of top managers who take responsibility for restructuring, for downsizing, and for changes in policies, goals, and control systems.
- A mechanistic organization structure is appropriate for frequent management changes, whereas an organic structure facilitates frequent technical changes.

12.6 Culture Change

Organizations are made up of people and their relationships with one another. Changes in strategy, structure, technologies, and products do not happen on their own, and changes in any of these areas involve changes in people as well. Employees must learn how to use new technologies, or market new products, or work

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effectively in interdisciplinary teams, as at GlaxoSmithKline. Sometimes achieving a new way of thinking requires a focused change in the underlying corporate cultural values and norms. Changing corporate culture fundamentally shifts how work is done in an organization and can lead to renewed commitment and empowerment of employees, as well as a stronger bond between the company and its customers.[108]

However, changing culture can be particularly difficult because it challenges people's core values and established ways of thinking and doing things. Mergers and acquisitions often illustrate how tough culture change can be. Recall from the opening example in Chapter 11 that Whole Foods is struggling with culture change after the company was acquired by Amazon. As another example, officers at Mizuho Financial Group, which was formed from the merger of Dai-Ichi, Fuji Bank, and Industrial Bank of Japan, say cultural differences between the units created the biggest hurdle to integrating operations. Mizuho's structure, culture, and management systems came under scrutiny when the bank suffered a prolonged computer system breakdown following the March 11, 2011, earthquake that hit Japan. Bank officials have been working hard to create a unified corporate culture and speed the integration to prevent similar problems. Employee reviews of the company's work environment and culture on Glassdoor.com are mixed, with some people praising the company's work-life balance and positive culture while other reviews seem to indicate that the cultural integration is proceeding slowly.[109] Although cultural issues can sometimes make or break the success of a merger, many managers fail to consider culture as part of their merger and acquisition plans, says Chuck Moritt, a senior partner in Mercer's M&A consulting business.[110]

12.6a Forces for Culture Change

In addition to mergers, a number of other recent trends have contributed to a need for cultural makeovers at many companies. For example, the shift to horizontal forms of organizing such as the holacracy team structure, which we discussed in Chapter 3, requires greater focus on employee empowerment, collaboration, information sharing, and meeting customer needs, which means managers and employees need a new mindset. Mutual trust, risk-taking, and tolerance for mistakes become key cultural values in a holacractic organization.

Another force for culture change is the diversity of today's workforce. Diversity is a fact of life for today's organizations, and many are implementing new recruiting, mentoring, and promotion methods, diversity training programs, tough policies regarding sexual harassment and racial discrimination, and new benefits programs that respond to a more diverse workforce. Companies such as Pfizer, BAE, Dow Chemical, and Google are training employees and managers to recognize "unconscious bias," which refers to a hidden preference for certain groups or types of people that can influence decisions in hiring, performance appraisal, promotions, and so forth. After Dow sent hundreds of managers to unconscious bias training, the number of women in higher level positions increased. Executives believe the training played a role in realizing those diversity gains.[111] However, the underlying culture of an organization also has to change or all other efforts to support diversity will fail.

Finally, a growing emphasis on learning and adaptation in organizations calls for new cultural values. Recall from Chapter 1 that flexible, organic organizations that support learning and adaptation typically have more decentralized structures with empowered teams working directly with customers. There are few rules and procedures for performing tasks, and knowledge and control of tasks are located with employees rather than supervisors. Information is broadly shared, and employees,

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customers, suppliers, and partners all play a role in determining the organization's strategic direction. When managers want to shift to a more organic organization design, they have to instill new values, new attitudes, and new ways of thinking and working together.

Top executives at Taco Bell shaped a more adaptable learning culture that has turned the chain into one of the restaurant industry's top innovators.

IN PRACTICE
Taco Bell

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The culture shift at Taco Bell can be traced back to the Doritos Locos Taco (DLT), which the fast-food chain introduced in 2012. The DLT actually began with a trip to Home Depot. Staff members had to buy paint-spray guns to blast Doritos flavoring onto taco shells. But after prototype development, consumer taste tests were disappointing. Teams made up of employees from Taco Bell and Frito Lay spent months trying to get the right formula and technology so that the shells wouldn't break but would still snap and crunch. More than two years of working day and night, and 40 recipes later, the DLT went nationwide. It was a smash hit, with millions of tacos sold in the first week alone.

Since then, Taco Bell's innovation-focused culture has continued to evolve. Former CEO Brian Niccol, who was recently hired as Chipotle's new CEO, encouraged wild ideas to bubble up from anywhere. "From an innovation perspective, I'd love it if we had one person who just comes up with great ideas," said Taco Bell's chief innovation officer. "But it doesn't work that way. The strategy is getting different people together, having food around, and having conversations." Teams that include Taco Bell staff, customers, and people from major suppliers work together testing ideas that turn into products like Nacho Fries, the Quesalupa, the Naked Chicken Chalupa, or Cap'n Crunch Delights.

Innovation isn't limited to products. Every part of operations is up for continuous reinvention. The company has transformed the way it communicates with customers by intensely focusing on social media. The annual Friendsgiving event uses Internet influencers who test a special menu and post the party on Instagram and other platforms. Taco Bell is experimenting with new ways to configure restaurants, including an open kitchen concept that lets customers watch their food take shape and touch-screen ordering kiosks that let people customize their orders in near-limitless combinations.

Much of the culture change in recent years was driven by Niccol. Now that he's moved on to try to reinvigorate Chipotle, it is up to new top executives to keep the culture thriving.[112]

ASSESS YOUR ANSWER

3 Changing a company's culture is probably one of the hardest jobs a manager can undertake.

ANSWER: *Agree.* Changing people and culture is typically much more difficult than changing any other aspect of the organization. Managers often underestimate the difficulty of changing culture and fail to appreciate that it takes a determined, consciously planned effort over a long period of time.

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12.6b Culture Change Interventions

Managers use a variety of approaches and techniques for changing corporate culture, some of which we discussed in Chapter 11. One method of quickly bringing about culture change is known as **organization development** (OD), which focuses on the human and social aspects of the organization as a way to improve the organization's ability to adapt and solve problems. OD emphasizes the values of human development, fairness, openness, freedom from coercion, and individual autonomy that allows workers to perform the job as they see fit, within reasonable organizational constraints.[113] In the 1970s, OD evolved as a separate field that applied the behavioral sciences in a process of planned organization-wide change, with the goal of increasing organizational effectiveness. Today, the concept has been enlarged to examine how people and groups can change to an adaptive culture in a complex and turbulent environment. Organization development is not a step-by-step procedure to solve a specific problem but a process of fundamental change in the human and social systems of the organization, including organizational culture.[114]

OD uses knowledge and techniques from the behavioral sciences to create a learning environment through increased trust, open confrontation of problems, employee empowerment and participation, knowledge and information sharing, the design of meaningful work, cooperation and collaboration between groups, and the full use of human potential.

OD interventions involve training of specific groups or of everyone in the organization. For OD interventions to be successful, senior management in the organization must see the need for OD and provide enthusiastic support for the change. Techniques used by many organizations for improving people skills through OD include the following.

BRIEFCASE

As an organization manager, keep this guideline in mind:

Work with organization development consultants for large-scale changes in the attitudes, values, or skills of employees, and when trying to change the overall culture toward a more adaptable one.

Large Group Intervention. Most early OD activities involved small groups and focused on incremental change. However, in recent years there has been growing interest in the application of OD techniques to large group settings, which are more attuned to bringing about radical or transformational change in organizations operating in complex environments.[115] The **large group intervention** approach, sometimes referred to as "whole system in the room,"[116] brings together participants from all parts of the organization—often including key stakeholders from outside the organization as well—in an off-site setting to discuss problems or opportunities and plan for change. A large group intervention might involve 50 to 500 people and last for several days. As one example, global furniture retailer IKEA used the large-group intervention approach to completely re-conceptualize how the company operates. During 18 hours of meetings held over several days, 52 stakeholders created a new system for product design, manufacturing, and distribution, which involved cutting layers of hierarchy and decentralizing the organization.[117] All of the departments that had information, resources, or an interest in the design outcome worked together to create and implement the new system.

Using an off-site setting limits interference and distractions, enabling participants to focus on new ways of doing things. General Electric's "Work Out" program, described at the beginning of Chapter 1, is an ongoing process of solving problems, learning, and improving that begins with large off-site meetings that get people talking across functional, hierarchical, and organizational boundaries. Hourly and salaried workers come together from many different parts of the organization and join with managers, customers, and suppliers to discuss and solve specific problems.[118] The process forces a rapid analysis of ideas, the creation of

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solutions, and the development of a plan for implementation. Over time, Work Out creates a culture where ideas are rapidly translated into action and positive business results.[119]

Team Building. **Team building** promotes the idea that people who work together can work as a team. A work team can be brought together to discuss conflicts, goals, the decision-making process, communication, creativity, and leadership. The team can then plan to overcome problems and improve results. Team-building activities are also used in many companies to train task forces, committees, and new product development groups. These activities enhance communication and collaboration and strengthen the cohesiveness of organizational groups and teams.

Interdepartmental Activities. Representatives from different departments are brought together in a neutral location to expose problems or conflicts, diagnose the causes of joint problems, and plan improvements in communication and coordination. This type of intervention has been applied to union–management conflict, headquarters–field office conflict, interdepartmental conflict, and mergers.[120] One archival records-storage company found interdepartmental meetings to be a key means of building a culture based on team spirit and customer focus. People from different departments met for hour-long sessions every two weeks and shared their problems, told stories about their successes, and talked about things they had observed in the company. The meetings helped people understand the problems faced by other departments and see how everyone depended on each other to do their jobs successfully.[121]

UnitedHealth Group, the nation's largest health insurer and one of the most powerful companies in the healthcare industry, has used OD interventions to build a more humane and collaborative environment.

IN PRACTICE

United-Health Group

"We were too self-centered and needlessly aggressive," said Stephen Hemsley, executive chairman of the board and former CEO of UnitedHealth Group. Hemsley says the atmosphere within the company was toxic when he took over as CEO, with a lot of IQ, but not much EQ. To encourage more civil, emotionally intelligent, and collaborative behavior, Hemsley sent 8,000 managers to three-day sensitivity training programs to become more aware of their own biases and impact and be more sensitive to other people. "I'm not proud that we needed to change, but we did," he says.

Interestingly, Hemsley, a former accountant with a reputation as a numbers man, was not recruited for his people skills, but that is what he has brought to the company. Today, people at UnitedHealth are respectful of their role in one of the most sensitive areas of human endeavor. One of the guidelines people live by is "Assume positive intent." A major team-building experience at UnitedHealth is the annual broomball tournament held at headquarters in Minnesota. Inaugurated in 2010, the tournament is now a prized tradition held every winter, with 90 teams representing every area of the company participating.[122]

One of Hemsley's goals in changing the culture at UnitedHealth was to dispel "the image of a greedy colossus driven by numbers." Leading a healthcare revolution is a tough, never-ending challenge, especially "trying to find the right balance between the analytical and the emotional," he said.[123]

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REMEMBER THIS

- Culture changes are generally the responsibility of top management.
- Some recent trends that may create a need for broad-scale culture change in the organization are the shift to more decentralized or horizontal forms of organizing, increased organizational diversity, and a greater need for learning and adaptation. All of these changes require significant shifts in employee and manager attitudes and ways of working together.
- One method for bringing about this level of culture change is organization development (OD). OD focuses on the human and social aspects of the organization and uses behavioral science knowledge to bring about changes in attitudes and relationships.
- OD techniques include large group intervention, team building, and interdepartmental activities.

12.7 Tactics for Implementing Change

Managers and employees can think of inventive ways to improve the organization's technology, creative ideas for new products and services, fresh approaches to strategies and structures, or ideas for fostering adaptive cultural values, but until the ideas are put into action, they are worthless to the organization. Implementation is the most crucial part of the change process, but it is also the most difficult. Change is frequently disruptive and uncomfortable for managers as well as employees. Change is complex, dynamic, and messy, and implementation requires strong and persistent leadership. In this final section, we briefly discuss the role of leadership for change, some reasons for resistance to change, and techniques that managers can use to overcome resistance and successfully implement change.

12.7a Leadership for Change

One survey found that among companies that are successful innovators, 80 percent have top leaders who are innovation champions; that is, they frequently reinforce the value and importance of innovation. These leaders think about innovation, demonstrate its importance through their actions, and follow through to make sure people are investing time and resources in innovation issues.[124]

The leadership style of the top executive sets the tone for how effective an organization is at continuous adaptation and innovation. One style of leadership, referred to as *transformational leadership,* is particularly suited for bringing about change. Top leaders who use a transformational leadership style enhance organizational innovation both directly, by creating a compelling vision, and indirectly, by creating an environment that supports exploration, experimentation, risk-taking, and sharing of ideas.[125]

Successful change can happen only when managers and employees are willing to devote the time and energy needed to reach new goals. In addition, people need the coping skills to endure possible stress and hardship. Understanding and appreciating the *curve of change* enables managers to guide people successfully through the difficulties of change. The change curve, illustrated in Exhibit 12.8, is the psychological process people go through during a significant change.

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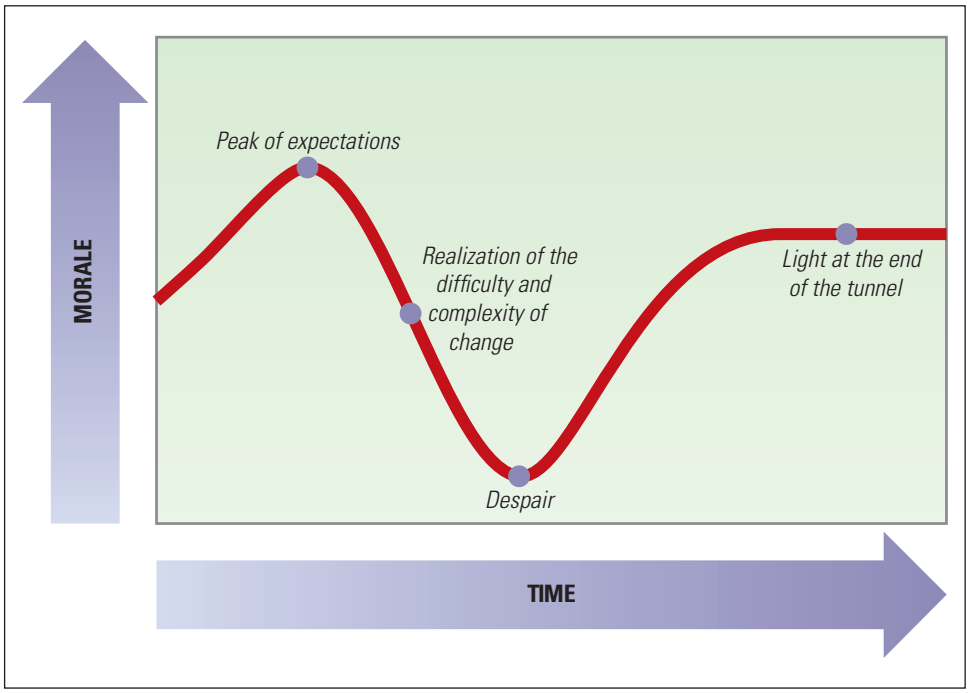
EXHIBIT 12.8
The Change Curve



Sources: Based on "Gartner Hype Cycle: Interpreting Technology Hype," Gartner Research, http://www.gartner.com/technology/research/methodologies/hype-cycle.jsp (accessed May 20, 2011); "The Change Equation and Curve," *21st Century Leader*, http://www.21stcenturyleader.co.uk/change_equation (accessed May 20, 2011); David M. Schneider and Charles Goldwasser, "Be a Model Leader of Change," *Management Review*, March 1998, 41–45; and Daryl R. Conner, *Managing at the Speed of Change* (New York: Villard Books, 1992).

For example, a manager sees a need for a change in work procedures in her department and initiates the change with high expectations for a smooth implementation and a positive outcome. As time progresses, people have difficulty altering their attitudes and behaviors. Employees may question why they need to do things a new way, the supervisor may begin to feel overwhelmed and frustrated, and everyone can potentially reach a point of despair that change is really possible. Performance may decline dramatically as people wrestle with the new procedures and resist the shift to a new way of working. Good change leaders drive through this period of despair rather than allowing it to sabotage the change effort. With effective change leadership, the changes can take hold and lead toward better performance. Managers at Procter & Gamble prepare themselves for a "60-day immune response" from users of a new work process. They expect that it takes 60 days to overcome resistance, work out the bugs in the new process, and reach the light at the end of the tunnel, when everyone begins to see positive results of the change.[126] Having a clearly communicated vision that embodies flexibility and openness to new ideas, methods, and styles sets the stage for a change-oriented organization and helps employees cope with the chaos and tension associated with change.

12.7b Techniques for Implementation

Top leaders articulate the vision and set the tone, but managers and employees throughout the organization are involved in the process of change. A number of techniques can be used to successfully implement change.[127]

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1. *Establish a sense of urgency for change.* Once managers identify a true need for change, they thaw resistance by creating a sense of urgency in others that the change is really needed. Organizational crises can help unfreeze employees and make them willing to invest the time and energy needed to adopt new techniques or procedures. When there is no obvious crisis, good managers find creative ways to make others aware of the need for change.
2. *Establish a coalition to guide the change.* Effective change managers build a coalition of people throughout the organization who have enough power and influence to steer the change process. For implementation to be successful, there must be a shared commitment to the need and possibilities for change. Top management support is crucial for any major change project, and lack of top management support is one of the most frequent causes of implementation failure.[128] In addition, the coalition should involve lower-level supervisors and middle managers from across the organization. For smaller changes, the support of influential managers in the affected departments is important.
3. *Create a vision and strategy for change.* Leaders who have taken their companies through major successful transformations often have one thing in common: they focus on formulating and articulating a compelling vision and strategy that will guide the change process. Even for a small change, a vision of how the future can be better and strategies to get there are important motivations for change.
4. *Find an idea that fits the need.* Finding the right idea often involves search procedures—talking with other managers, assigning a task force to investigate the problem, sending out a request to suppliers, or asking creative people within the organization to develop a solution. This is a good opportunity to encourage employee participation because employees need the freedom to think about and explore new options.[129]
5. *Create change teams.* This chapter has emphasized the need for resources and energy to make change happen. Separate creative departments, new-venture groups, and ad hoc teams or task forces are ways to focus energy on both creation and implementation. A separate department has the freedom to create a new technology that fits a genuine need. A task force can be created to see that implementation is completed. The task force can be responsible for communication, involvement of users, training, and other activities needed for change.
6. *Foster idea champions.* One of the most effective weapons in the battle for change is the idea champion. The most effective champion is a volunteer champion who is deeply committed to a new idea. The idea champion sees that all technical activities are correct and complete. An additional champion, such as a manager sponsor, may also be needed to persuade people about implementation.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Understand the curve of change so you can prevent yourself and others from falling prey to frustration and despair when implementing a major change. To achieve successful implementation, use techniques such as obtaining top management support, implementing the change in a series of steps, and assigning change teams or idea champions.

12.7c Techniques for Overcoming Resistance

Many good ideas are never used because managers failed to anticipate or prepare for resistance to change by customers, employees, or other managers. No matter how impressive the performance characteristics of an innovation, its implementation will conflict with some interests and jeopardize some alliances in the organization. To increase the chance of successful implementation, managers acknowledge the conflict, threats, and potential losses perceived by employees. Several strategies can be used by managers to overcome resistance:

1. *Top management support.* The visible support of top management makes people aware of the importance of the change. For instance, one of the primary correlates of the success of new business ventures is the strong support of

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top managers, which gives the project legitimacy.[130] Top management support is especially important when a change involves multiple departments or when resources are being reallocated among departments. Without top management support, changes can get bogged down in squabbling among departments or contradictory orders from lower-level managers.

2. *Participation and involvement.* Early and extensive participation in a change should be part of implementation. Participation gives those involved a sense of control over the change activity. They understand it better, and they become committed to its successful implementation.[131] At Domino's, some franchise owners resisted the switch to a new point-of-sale (POS) system that headquarters managers mandated as part of a drive to improve accuracy, boost efficiency, and increase profits. The franchisees hadn't been involved in the process of designing and configuring the new system, and many of them wanted to stay with the system they were accustomed to. "It was hard for a lot of us to embrace," said Tony Osani, who owns 16 Domino's restaurants in the Huntsville, Alabama, area.[132] The team-building and large group intervention activities described earlier can be effective ways to involve employees in a change process.
3. *Alignment with needs and goals of users.* The best strategy for overcoming resistance is to make sure change meets a real need. Employees in R&D often come up with great ideas that solve nonexistent problems. This happens because initiators fail to consult with the intended users. Resistance can be frustrating for managers, but moderate resistance to change is good for an organization. Resistance provides a barrier to frivolous changes and to change for the sake of change. The process of overcoming resistance to change normally requires that the change be good for its users. When David Zugheri wanted to switch to a primarily paperless system at First Houston Mortgage, he emphasized to employees that storing customer records electronically meant they could now work from home when they needed to care for a sick child, or take a vacation and still keep track of critical accounts. "I could literally see their attitudes change through their body language," Zugheri says.[133]
4. *Communication and training.* Communication means informing users about the need for change and the consequences of a proposed change, preventing rumors, misunderstanding, and resentment. In one study of change efforts, the most commonly cited reason for failure was that employees learned of the change from outsiders. Top managers concentrated on communicating with the public and shareholders but failed to communicate with the people who would be most intimately involved with and most affected by the change—their own employees.[134] Open communication often gives managers an opportunity to explain what steps will be taken to ensure that the change will have no adverse consequences for employees. Training is also needed to help people understand and cope with their role in the change process.
5. *An environment that affords psychological safety.* Psychological safety means that people feel a sense of confidence that they will not be embarrassed or rejected by others in the organization. People need to feel secure and capable of making the changes that are asked of them.[135] Change requires that employees be willing to take risks and do things differently, but many people are fearful of trying something new if they think they might be embarrassed by mistakes or failure. Managers support psychological safety by creating a climate of trust and mutual respect in the organization. "Not being afraid someone is laughing at you helps you take genuine risks," says Andy Law, one of the founders of St. Luke's, an advertising agency based in London.[136]

BRIEFCASE

As an organization manager, keep this guideline in mind:

Overcome resistance to change by actively communicating with workers and encouraging their participation in the change process.

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Learning to manage change effectively, including understanding the change curve and knowing ways to overcome resistance, is crucial, particularly when top-down changes are needed. The failure to recognize and overcome resistance is one of the primary reasons managers fail to implement new strategies that can keep their companies competitive.[137] Smart managers approach the change process mindfully and consistently, planning for implementation and preparing for resistance.

REMEMBER THIS

- The implementation of change can be difficult. Strong leadership is needed to guide employees through the turbulence and uncertainty and build organization-wide commitment to change.
- Understanding the curve of change can help leaders push through the despair and frustration often associated with major change.
- Managers can increase the likelihood of success by thoughtfully planning how to deal with resistance.
- Implementation techniques are to establish a sense of urgency that change is needed, create a powerful coalition to guide the change, formulate a vision and strategy to achieve the change, and foster change teams and idea champions.
- To overcome resistance, managers can gain the support of top management, include users in the change process, align the change with the needs and goals of users, and provide psychological safety.

KEY CONCEPTS

ambidextrous approach
change process
creative departments
creativity
crowdsourcing
culture innovations
disruptive innovation
dual-core approach
horizontal coordination model
idea champions
idea incubator
large group intervention
management innovation
new-venture fund
open innovation
organization development
organizational change
organizational innovation
product and service innovations
skunkworks
strategy and structure innovations
switching structures
team building
technology innovations
venture teams

DISCUSSION QUESTIONS

1. Why do you think crowdsourcing has become popular in recent years? What might be some disadvantages of taking a crowdsourcing approach? When might a company be better off taking a more limited approach to open innovation?
2. Describe the dual-core approach. How does the process of management innovation normally differ from technology change? Discuss.
3. What does it mean to say managers should organize for both exploration and exploitation?
4. Do you think factory employees would typically be more resistant to changes in production methods, changes in structure, or changes in culture? Why? What steps could managers take to overcome this resistance?
5. "Change requires more coordination than does the performance of normal organizational tasks. Any time you change something, you discover its connections to other parts of the organization, which have to be changed as well." Discuss whether you agree or disagree with this quote, and why.

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6. A noted organization theorist said, "Pressure for change originates in the environment; pressure for stability originates within the organization." Do you agree? Discuss.
7. Of the five elements in Exhibit 12.3 required for successful change, which element do you think managers are most likely to overlook? Discuss.
8. How do the underlying values of organization development compare to the values underlying other types of change? Why do the values underlying OD make it particularly useful in shifting to a high-performance culture as described in Chapter 11 (Exhibit 11.5)?
9. The manager of R&D for a drug company said that only five percent of the company's new products ever achieve market success. She also said the industry average is 10 percent and wondered how her organization might increase its success rate. If you were acting as a consultant, what advice would you give her about designing organization structure to improve market success?
10. Examine the change curve illustrated in Exhibit 12.8 and the five techniques for overcoming resistance to change discussed at the end of the chapter. Describe at which point along the change curve managers could use each of the five techniques to successfully implement a major change.

CHAPTER 12 WORKSHOP Innovation Climate[138]

In order to examine differences in the level of innovation encouragement in organizations, you will be asked to rate two organizations. The first should be an organization in which you have work experience, or your university. The second should be someone else's workplace—that of a family member, a friend, or an acquaintance. You will have to interview that person to answer the following questions. You should put your own answers in column A, your interviewee's answers in column B, and what you think would be the ideal in column C.

Innovation Measures

Item of Measure	A Your Organization	B Other Organization	C Your Ideal
Score items 1–5 on this scale: 1 = *don't agree at all* to *5 = agree completely*			
1. Creativity is encouraged here.†			
2. People are allowed to solve the same problems in different ways.†			
3. I get to pursue creative ideas.‡			
4. The organization publicly recognizes and also rewards those who are innovative.‡			
5. Our organization is flexible and always open to change.†			
Score items 6–10 on the opposite scale: 1 = *agree completely* to *5 = don't agree at all*			
6. The primary job of people here is to follow orders that come from the top.†			
7. The best way to get along here is to think and act like others.†			
8. This place seems to be more concerned with the status quo than with change.†			
9. People are rewarded more if they don't rock the boat.‡			
10. New ideas are great, but we don't have enough people or money to carry them out.‡			

† These items indicate the organization's innovation climate.
‡ These items show resource support.

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Questions

Break into small groups of 3–4 people and discuss the following questions:

1. What comparisons in terms of innovation climates can you make between the two organizations?
2. How might productivity differ between a climate that supports innovation and a climate that does not?
3. Where would you rather work? Why?

CASE FOR ANALYSIS | Fabulous Footwear [139]

Fabulous Footwear produces a line of women's shoes that sell in the lower-price market for $27.99 to $29.99 per pair. Profits averaged 30 cents to 50 cents per pair 10 years ago, but according to the president and the controller, labor and materials costs have risen so much in the intervening period that profits today average only 25 cents to 30 cents per pair.

Production at both the company's plants totals 12,500 pairs per day. The two factories are located within a radius of 60 miles of Chicago: one at Centerville, which produces 4,500 pairs per day, and the other at Meadowvale, which produces 8,000 pairs per day. Company headquarters is located in a building adjacent to the Centerville plant.

It is difficult to give an accurate picture of the number of items in the company's product line. Shoes change in style perhaps more rapidly than any other style product, including garments. This is chiefly because it is possible to change production processes quickly and because, historically, each company, in attempting to get ahead of competitors, gradually made style changes more frequently. At present, including both major and minor style changes, Fabulous Footwear offers 100 to 120 different products to customers each year.

A partial organizational chart, showing the departments involved in this case, appears in Exhibit 12.9.

Competitive Structure of the Industry

Very large general shoe houses, such as International and Brown, carry a line of women's shoes and are able to undercut prices charged by Fabulous Footwear, principally because of the policy in the big companies of producing large numbers of "stable" shoes, such as the plain pump and the loafer. They do not attempt to change styles as rapidly as their smaller competitors. Thus, without constant changes in production processes and sales presentations, they are able to keep costs substantially lower.

Charles F. Allison, the president of Fabulous Footwear, feels that the only way for a small independent company to be competitive is to change styles frequently, taking advantage of the flexibility of a small organization to create designs that appeal to customers. Thus, demand can be created and a price set high enough to make a profit. Allison, incidentally, appears to have an artistic talent in styling and a record of successful judgments in approving high-volume styles over the years.

Regarding how Fabulous Footwear differs from its large competitors, Allison has said:

You see, Brown and International Shoe Company both produce hundreds of thousands of the same pair of shoes. They store them in inventory at their factories. Their customers, the large wholesalers and retailers, simply know their line and send in orders. They do not have to change styles nearly as often as we do. Sometimes I wish we could do that, too. It makes for a much more stable and orderly system. There is also less friction between people inside the company. The salespeople always know what they're selling; the production people know what is expected of them. The plant personnel are not shook up so often by someone coming in one morning and tampering with their machine lines or their schedules. The styling people are not shook up so often by the plant saying, "We can't do your new style the way you want it."

To help Fabulous Footwear be more competitive against larger firms, Allison recently created an e-commerce and social media department. Although his main interest was in marketing over the Internet, he also hoped new technology would help reduce some of the internal friction by giving people an easier way to communicate. He invested in sophisticated new information technology and hired consultants to set up a company intranet and provide a few days' training to upper and middle managers. Katherine Olsen came on board as director of e-commerce, charged primarily with coordinating Internet marketing and sales. When she took the job, she had visions of one day offering consumers the option of customized shoe designs. However, Olsen was somewhat surprised to learn that most employees still refused to use the intranet even for internal communication and coordination. The process for deciding on new styles, for example, had not changed since the 1980s.

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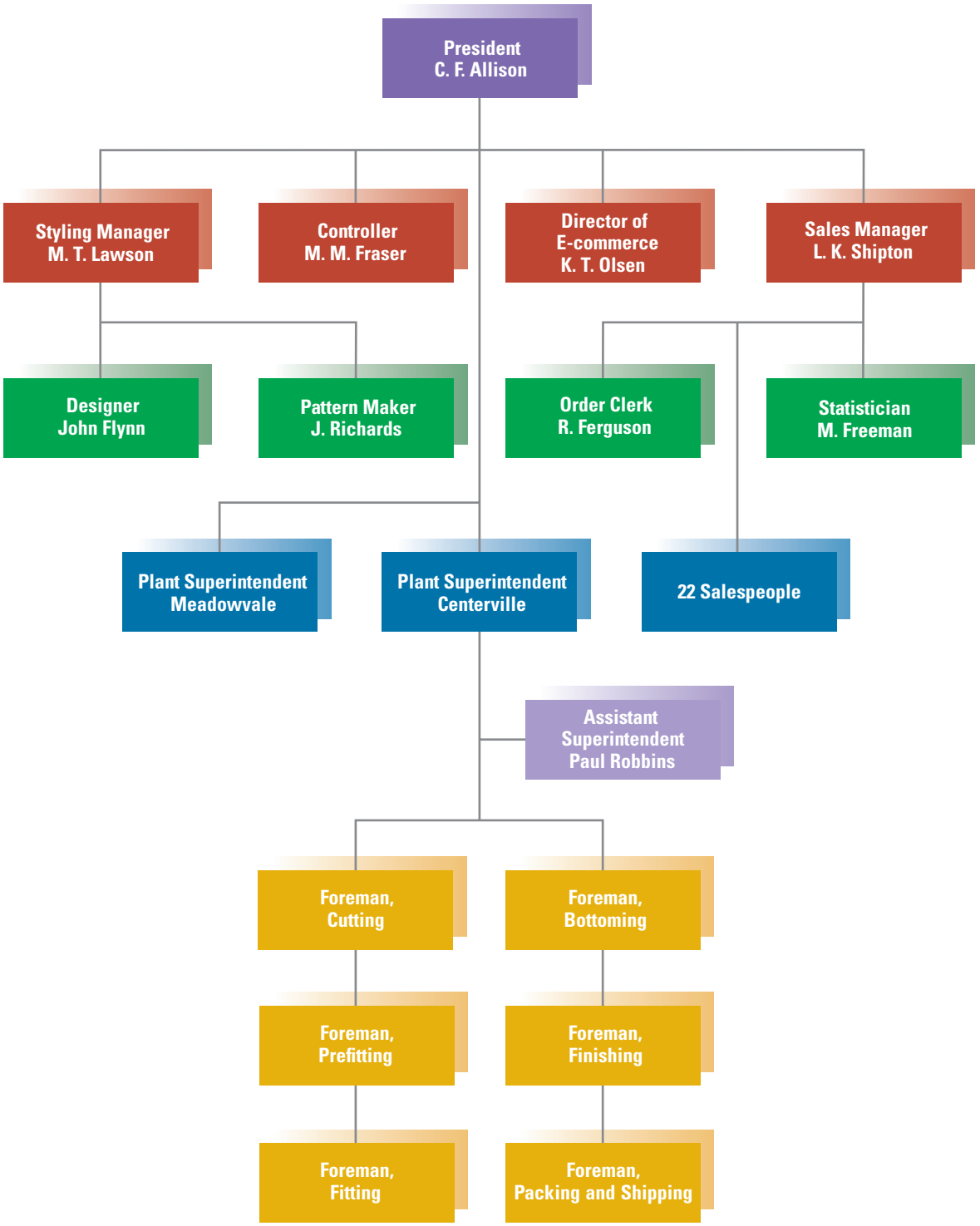
EXHIBIT 12.9
Partial Organization Chart of Fabulous Footwear



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Major Style Changes

The decision about whether to put a certain style into production requires information from a number of different people. Here is what typically happens in the company. It may be helpful to follow the organization chart (see Exhibit 12.9) tracing the procedure.

M. T. Lawson, the styling manager, and his designer, John Flynn, originate most of the ideas about shape, size of heel, use of flat sole or heels, and findings (the term used for ornaments attached to, but not part of, the shoes—bows, straps, and so forth). They get their ideas principally from reading style and trade magazines or by copying top-flight designers. Lawson corresponds with publications and friends in large stores in New York, Rome, and Paris to obtain pictures and samples of up-to-the-minute style innovations. Although he uses e-mail occasionally, Lawson prefers telephone contact and receiving drawings or samples by overnight mail. Then, he and Flynn discuss various ideas and come up with design options.

When Lawson decides on a design, he takes a sketch to Allison, who either approves or disapproves it. If Allison approves, he (Allison) then passes the sketch on to L. K. Shipton, the sales manager, to find out what lasts (widths) should be chosen. Shipton, in turn, forwards the design to Martin Freeman, a statistician in the sales department, who maintains summary information on customer demand for colors and lasts.

To compile this information, Freeman visits salespeople twice a year to get their opinions on the colors and lasts that are selling best, and he keeps records of shipments by color and by last. For these needs, he simply totals data that are sent to him by the shipping foreman in each of the two plants.

When Freeman has decided on the lasts and colors, he sends Allison a form that lists the colors and lasts in which the shoe should be produced. Allison, if he approves this list, forwards the information to Lawson, who passes it on to Jenna Richards, an expert pattern maker. Richards makes a paper pattern and then constructs a prototype in leather and paper. She sends this to Lawson, who in turn approves or disapproves it. He forwards any approved prototype to Allison. Allison, if he, too, approves, notifies Lawson, who takes the prototype to Paul Robbins, assistant to the superintendent of the Centerville plant. Only this plant produces small quantities of new or experimental shoe styles. This is referred to as a "pilot run" by executives at the plant.

Robbins then literally carries the prototype through the six production departments of the plant—from cutting to finishing—discussing it with each foreman, who in turn works with employees on the machines in having a sample lot of several thousand pairs made. When the finished lot is delivered by the finishing foreman to the shipping foreman (because of the importance of styling, Allison has directed that each foreman personally deliver styling goods in process to the foreman of the next department), the latter holds the inventory in storage and sends one pair each to Allison and Lawson. If they approve of the finished product, Allison instructs the shipping foreman to mail samples to each of the company's twenty-two salespeople throughout the country. Olsen also receives samples, photos, and drawings to post on the web page and gauge customer interest.

Salespeople have instructions to take the samples immediately (within one week) to at least 10 customers. Orders for already established shoes are normally sent to Ralph Ferguson, a clerk in Shipton's office, who records them and forwards them to the plant superintendents for production. However, salespeople have found by experience that Martin Freeman has a greater interest in the success of new "trials," so they rush these orders to him by overnight mail, and he in turn places the first orders for a new style in the interoffice mail to the plant superintendents. He then sends off a duplicate of the order, mailed in by the salespeople, to Ferguson for entering in his statistical record of all orders received by the company.

Three weeks after the salespeople receive samples, Allison requires Ralph Ferguson to give him a tabulation of orders. At that time, he decides whether the salespeople and the web page should push the item and the superintendents should produce large quantities, or whether he will tell them that although existing orders will be produced, the item will be discontinued in a short time.

According to Allison, the procedures outlined here have worked reasonably well.

The average time from when Lawson decides on a design until we notify the Centerville plant to produce the pilot run is two weeks to a month. Of course, if we could speed that up, it would make the company just that much more secure in staying in the game against the big companies, and in taking sales away from our competitors. There seems to be endless bickering among people around here involved in the styling phase of the business. That's to be expected when you have to move fast—there isn't much time to stop and observe all of the social amenities. I have never thought that a formal organization chart would be good in this company—we've worked out a customary system here that functions well.

M. T. Lawson, manager of styling, said that within his department all work seems to get out in minimum time; he also stated that both Flynn and Richards are good employees and skilled in their work. He mentioned that Flynn had been in to see him twice in the last year:

To inquire about his [Flynn's] future in the company. He is 33 years old and has three children. I know that he is eager to make money, and I assured him that over the years we can raise him right along from the $65,000 we are now paying. Actually, he has learned a lot about shoe styles since we hired him from the design department of a fabric company six years ago.

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John Flynn revealed:

I was actually becoming dissatisfied with this job. All shoe companies copy styles—it's a generally accepted practice within the industry. But I've picked up a real feel for designs, and several times I've suggested that the company make all its own original styles. We could make Fabulous Footwear a style leader and also increase our volume. When I ask Lawson about this, he says it takes too much time for the designer to create originals—that we have all we can handle to do research in trade magazines and maintain contracts feeding us the results of experts. Besides, he says our styles are standing the test of the marketplace.

Projects X and Y

Flynn also said that he and Martin Freeman had frequently talked about the styling problem. They felt that:

Allison is really a great president, and the company surely would be lost without him. However, we've seen times when he lost a lot of money on bad judgments in styles. Not many times—perhaps six or seven times in the last eighteen months. Also, he is, of course, extremely busy as president of the corporation. He must look after everything from financing from the banks to bargaining with the union. The result is that he is sometimes unavailable to do his styling approvals for several days, or even two weeks. In a business like this, that kind of delay can cost money. It also makes him slightly edgy. It tends, at times when he has many other things to do, to make him look quickly at the styles we submit, or the prototypes Richards makes, or even the finished shoes that are sent for approval by the shipping foreman. Sometimes I worry that he makes two kinds of errors. He simply rubber-stamps what we've done, which makes sending these things to him a waste of time. At other times he makes snap judgments of his own, overruling those of us who have spent so much time and expertise on the shoe. We do think he has good judgment, but he himself has said at times that he wishes he had more time to concentrate on styling and approval of prototypes and final products.

Flynn further explained (and this was corroborated by Freeman) that the two had worked out two plans, which they referred to as "project X" and "project Y." In the first, Flynn created an original design that was not copied from existing styles. Freeman then gave special attention to color and last research for the shoe and recommended a color line that didn't exactly fit past records on consumer purchases—but one he and Flynn thought would have "great consumer appeal." This design and color recommendation was accepted by Lawson and Allison; the shoe went into production and was one of the three top sellers during the calendar year. The latter two men did not know that the shoe was styled in a different way from the usual procedure.

The result of a second, similar project (Y) was put into production the next year, but this time sales were discontinued after three weeks.

Problem Between Lawson and Robbins

Frequently, perhaps 10 to 12 times a year, disagreement arises between Mel Lawson, manager of styling, and Paul Robbins, assistant to the superintendent of the Centerville plant. Robbins said:

The styling people don't understand what it means to produce a shoe in the quantities that we do, and to make the changes in production that we have to. They dream up a style quickly, out of thin air. They do not realize that we have a lot of machines that have to be adjusted and that some things they dream up take much longer on certain machines than others, thus creating a bottleneck in the production line. If they put a bow or strap in one position rather than another, it may mean we have to keep people idle on later machines while there is a pileup on the sewing machines on which this complicated little operation is performed. This costs the plant money. Furthermore, there are times when they get the prototype here late, and either the foremen and I work overtime or the trial run won't get through in time to have new production runs on new styles, to take the plant capacity liberated by our stopping production on old styles. Lawson doesn't know much about production and sales and the whole company. I think all he does is to bring shoes down here to the plant, sort of like a messenger boy. Why should he be so hard to get along with? He isn't getting paid any more than I am, and my position in the plant is just as important as his.

Lawson, in turn, said that he has a difficult time getting along with Robbins:

There are many times when Robbins is just unreasonable. I take prototypes to him five or six times a month, and other minor style changes to him six or eight times. I tell him every time that we have problems in getting these ready, but he knows only about the plant, and telling him doesn't seem to do any good. When we first joined the company, we got along all right, but he has gotten harder and harder to get along with.

Other Problems

Ralph Ferguson, the clerk in the sales department who receives orders from salespeople and forwards totals for production schedules to the two plant superintendents, has complained that the salespeople and Freeman are bypassing him in their practice of sending experimental shoe orders to Freeman. He insisted that his job description (one of only

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two written descriptions in the company) gives him responsibility for receiving all orders throughout the company and for maintaining historical statistics on shipments.

Both the salespeople and Freeman, on the other hand, said that before they started the new practice (that is, when Ferguson still received the experimental shoe orders), there were at least 8 or 10 instances a year when these were delayed from 1 to 3 days on Ferguson's desk. They reported that Ferguson just wasn't interested in new styles, so the salespeople "just started sending them to Freeman." Ferguson acknowledged that there were times of short delay, but said that there were good reasons for them:

They [the salespeople and Freeman] are so interested in new designs, colors, and lasts that they can't understand the importance of a systematic handling of the whole order procedure, including both old and new shoe styles. There must be accuracy. Sure, I give some priority to experimental orders, but sometimes when rush orders for existing company products are piling up, and when there's a lot of planning I have to do to allocate production between Centerville and Meadowvale, I decide which comes first—processing of these, or processing the experimental shoe orders. Shipton is my boss, not the salespeople or Freeman. I'm going to insist that these orders come to me.

The Push for New Technology

Katherine Olsen believes many of these problems could be solved through better use of technology. She has approached Charles Allison several times about the need to make greater use of the expensive and sophisticated computer information systems he had installed. Although Allison always agrees with her, he has so far done nothing to help solve the problem. Olsen thinks the new technology could dramatically improve coordination at Fabulous Footwear.

Everyone needs to be working from the same data at the same time. As soon as Lawson and Flynn come up with a new design, it should be posted on the intranet so all of us can be informed. And everyone needs access to sales and order information, production schedules, and shipping deadlines. If everyone—from Allison down to the people in the production plants—was kept up to date throughout the entire process, we wouldn't have all this confusion and bickering. But no one around here wants to give up any control—they all have their own little operations and don't want to share information with anyone else. For example, I sometimes don't even know there's a new style in the works until I get finished samples and photos. No one seems to recognize that one of the biggest advantages of the Internet is to help stay ahead of changing styles. I know that Flynn has a good feel for design, and we're not taking advantage of his abilities. But I also have information and ideas that could help this company keep pace with changes and really stand out from the crowd. I don't know how long we expect to remain competitive using this cumbersome, slow-moving process and putting out shoes that are already behind the times.

Questions

1. How would you characterize the structure of Fabulous Footwear? Explain.
2. In what ways is the structure appropriate or inappropriate for frequent changes in shoe styles? What structure changes would you recommend?
3. If you were the CEO, how would you get employees to use the new information technology available within Fabulous Footwear?

CASE FOR ANALYSIS | Lamprey, Inc.[140]

Jim Malesckowski remembered the call of two weeks ago as if he had just put down the telephone receiver: "I just read your analysis and I want you to get down to Mexico right away," Jack Ripon, his boss and chief executive officer, had blurted in his ear. "You know we can't make the plant in Oconomo work anymore—the costs are just too high. So go down there, check out what our operational costs would be if we move, and report back to me in a week."

As president of the Wisconsin Specialty Products Division of Lamprey Inc., Jim knew quite well the challenge of dealing with high-cost labor in a third-generation, unionized, U.S. manufacturing plant. And although he had done the analysis that led to his boss's knee-jerk response, the call still stunned him. There were 520 people who made a living at Lamprey's Oconomo facility, and if it closed, most of them wouldn't have a chance of finding another job in the town of 9,900 people.

Instead of the $16-per-hour average wage paid at the Oconomo plant, the wages paid to the Mexican workers—who lived in a town without sanitation and with an unbelievably toxic effluent from industrial pollution—would amount to about $1.60 an hour on average. That would be a saving of nearly $15 million a year for Lamprey, to be offset in part by increased costs for training, transportation, and other matters.

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After two days of talking with Mexican government representatives and managers of other companies in the town, Jim had enough information to develop a set of comparative figures of production and shipping costs. On the way home, he started to outline the report, knowing full well that unless some miracle occurred, he would be ushering in a blizzard of pink slips for people he had come to appreciate.

The plant in Oconomo had been in operation since 1921, making special apparel for people suffering from injuries and other medical conditions. Jim had often talked with employees who would recount stories about their fathers or grandfathers working in the same Lamprey company plant—the last of the original manufacturing operations in town.

But friendship aside, competitors had already edged past Lamprey in terms of price and were dangerously close to overtaking it in product quality. Although both Jim and the plant manager had tried to convince the union to accept lower wages, union leaders resisted. In fact, on one occasion when Jim and the plant manager tried to discuss a cell manufacturing approach, which would cross-train employees to perform up to three different jobs, local union leaders could barely restrain their anger. Jim thought he sensed an underlying fear, meaning the union reps were aware of at least some of the problems, but he had been unable to get them to acknowledge this and move on to open discussion.

A week passed and Jim had just submitted his report to his boss. Although he didn't specifically bring up the point, it was apparent that Lamprey could put its investment dollars in a bank and receive a better return than what its Oconomo operation was currently producing.

The next day, he would discuss the report with the CEO. Jim didn't want to be responsible for the plant's dismantling, an act he personally believed would be wrong as long as there was a chance its costs could be lowered. "But Ripon's right," he said to himself. "The costs are too high, the union's unwilling to cooperate, and the company needs to make a better return on its investment if it's to continue at all. It sounds right but feels wrong. What should I do?"

Questions

1. Should the company go ahead with the move to Mexico or try one more time to work things out in the Oconomo facility? Explain your reasoning.
2. If Jim decides to try to turn around the plant in order to keep the jobs in Oconomo, how should he go about implementing the change? What steps should he take?
3. Why do you think the union leaders are resisting change so strongly? How might Jim overcome the union leaders' resistance to change?

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CHAPTER

13 Decision-Making Processes

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Learning Objectives

After reading this chapter you should be able to:

1. Explain the differences between programmed and nonprogrammed decisions.
2. Describe the ideal, rational approach to decision making comparing it with the bounded rationality approach to decision making.
3. Describe how cognitive biases can cause decision errors.
4. Explain the management science approach to decision making.
5. Describe the Carnegie and incremental decision models.
6. Identify the components of the garbage can model of decision making.
7. Explain how to determine the best decision-making approach by using the contingency decision-making framework.
8. Describe how high-velocity environments and decision mistakes influence decision making for today's managers.

Chapter Outline

Types of Decisions

Individual Decision Making

Rational Approach • Bounded Rationality Perspective

Cognitive Biases

Biases That Influence Decisions • Overcoming Cognitive Biases

Organizational Decision Making

Management Science Approach • Carnegie Model • Incremental Decision Model

Organizational Decisions and Change

Combining the Incremental and Carnegie Models • Garbage Can Model

Contingency Decision-Making Framework

Problem Consensus • Technical Knowledge about Solutions • Contingency Framework

Special Decision Circumstances

High-Velocity Environments • Decision Mistakes and Learning

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **Managers should use the most objective, rational process possible when making a decision.**

I AGREE _____ I DISAGREE _____

2 **When a manager knows the best solution to a serious organizational problem and has the necessary authority, it is best to simply make the decision and implement it rather than involve other managers in the decision process.**

I AGREE _____ I DISAGREE _____

3 **Making a poor decision can help a manager and organization learn and get stronger.**

I AGREE _____ I DISAGREE _____

What is one activity every manager—no matter what level of the hierarchy, what industry, or what size or type of organization—engages in every day? Decision making. Managers are often referred to as *decision makers*, and every organization grows, prospers, or fails as a result of the choices managers make. However, many decisions can be risky and uncertain, without any guarantee of success. Ron Johnson, who was the brain behind Apple's retail stores and formerly a successful executive at Target, thought he had the winning formula to bring department store chain J.C. Penney back from the brink. Johnson decided to remake Penney into a more upscale, youth-oriented retailer, but the decision failed. Johnson was ousted after only 16 months, and Penney lost $1 billion during his one full year as CEO.[1] Or consider the damage done to the reputation of General Motors (GM) when investigations into quality and safety problems revealed that managers had delayed decisions that might have saved lives. Top executives at GM admitted that some managers knew about faulty ignition switches for more than a decade before crashes and deaths linked to the problem caused them to issue a recall of 2.6 million vehicles.[2] In hindsight, the decision to issue a recall seems like a no-brainer, but the situation wasn't so clear-cut at the time. Decision making is done amid constantly changing factors, unclear information, and conflicting points of view, and even the best managers in the most successful companies sometimes make big blunders.

Yet managers also make many successful decisions every day. Apple has topped *Fortune* magazine's list of the world's most admired companies for 12 straight years, but the company was all but dead in the mid-1990s. If the board had not decided to bring back co-founder Steve Jobs as CEO (he had been fired from his own company years earlier), Apple might not even exist today. In 1996, Apple lost $816 million on sales of $9.8 billion. Yet, thanks to decisions made by Jobs (who led the company from 1997 until he died in 2011) and other top managers, Apple is soaring today. Over a span of about two decades, Apple went from near bankruptcy to achieve a (temporary) market valuation of more than $1 trillion in late 2018. The decision to bring Jobs back has been called one of the greatest business decisions of all time. Apple managers have continued to make good decisions that led to the company being ranked at the top of *Fortune*'s 2019 list in numerous areas, including

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people management, innovation, and quality of products and services.[3] There are also examples from industries very different from the one Apple operates in. Decisions made by the leadership team of Delta Airlines helped Delta achieve a record high in profitability for the airline industry. Delta was also ranked in early 2019 at the top of the 29th annual Airline Quality Rating, which ranks the nine largest airlines in the United States based on factors such as on-time performance, mishandled baggage, and customer complaints. Among the four largest U.S. carriers, Delta was the only airline not flying any of the Boeing 737 Max jets that were grounded after two fatal crashes. So, while United, American, and Southwest were having to cancel thousands of flights, Delta kept flying and raking in money.[4]

Purpose of This Chapter

At any time, an organization may be identifying problems and implementing alternatives for hundreds of decisions. Managers and organizations somehow muddle through these processes.[5] The purpose here is to analyze these processes to learn what decision making is actually like in organizational settings. Decision-making processes can be thought of as the brain and nervous system of an organization. Decision making is the end use of the information and control systems described in Chapters 9 and 11.

First, the chapter defines decision making and the different types of decisions managers make. The next section describes an ideal model of decision making and then examines how individual managers actually make decisions, including the role of intuition and how cognitive biases may influence decision making. The chapter also explores several models of organizational decision making, each of which is appropriate in a different organizational situation. The next section combines the models into a single framework that describes when and how the various approaches should be used. Finally, the chapter discusses special issues related to decision making, such as high-velocity environments and learning from decision mistakes.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Adapt decision processes to fit the organizational situation. Understand how processes differ for programmed and nonprogrammed decisions.

13.1 Types of Decisions

Organizational decision making is formally defined as the process of identifying and solving problems. The process has two major stages. In the **problem identification** stage, information about environmental and organizational conditions is monitored to determine if performance is satisfactory and to diagnose the cause of shortcomings. The **problem solution** stage is when alternative courses of action are considered and one alternative is selected and implemented.

Organizational decisions vary in complexity and can be categorized as programmed or nonprogrammed.[6] **Programmed decisions** are repetitive and well defined, and procedures exist for resolving the problem. They are well structured because criteria of performance are normally clear, good information is available about current performance, alternatives are easily specified, and there is relative certainty that the chosen alternative will be successful. Examples of programmed decisions include decision rules, such as when to replace an office copy machine, when to reimburse managers for travel expenses, or whether an applicant has

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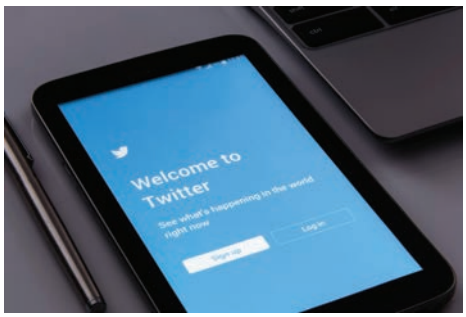
sufficient qualifications for an assembly-line job. Many companies adopt rules based on experience with programmed decisions. For example, a rule for hotel managers assigning staff for banquets is to allow one server per 30 guests for a sit-down function and one server per 40 guests for a buffet.[7] Today these kinds of routine, programmed decisions are often handled by artificial intelligence (AI), as described in Chapter 9. For example, Royal Dutch Shell has begun using AI algorithms in some areas of its business to assign employees with the right skills and expertise to work on various projects. An algorithm can schedule work more efficiently, freeing managers' time for more complex, nonprogrammed decisions.[8]

Nonprogrammed decisions are novel and poorly defined, and no procedure exists for solving the problem. They are used when an organization has not seen a problem before and may not know how to respond. Clear-cut decision criteria do not exist. Alternatives are fuzzy. There is uncertainty about whether a proposed solution will solve the problem. Typically, few alternatives can be developed for a nonprogrammed decision, so a single solution is custom-tailored to the problem. Many nonprogrammed decisions involve strategic planning where uncertainty is great and decisions are complex.

Like managers at most companies, managers at fast-food chain McDonald's face both programmed and nonprogrammed decisions. When executives face the decision about opening a new restaurant in the United States, they can analyze local demographics, traffic patterns, prices and availability of real estate, and where competitors are in the area. Combining these data with restaurant revenue and cost models, managers can make a reasonably good choice for a new location. This represents a *programmed decision*. However, the decision to open a restaurant for the first time in a less-developed country is not so easy. Managers have much less information and less understanding of the local market. The company's products are new to the region; the store will be facing unfamiliar competitors; it has less experience with suppliers; and hiring and training practices must be built from the ground up. This is a truly *nonprogrammed decision* and could even turn into a "wicked" decision if some managers disagree over where and how to enter the new market.[9]

Particularly complex nonprogrammed decisions are often referred to as wicked decisions because simply defining the problem can turn into a major task. Consider the following example from Twitter.



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IN PRACTICE
Twitter

"Please bear with me," one team member said. "This is incredibly complex." Twitter CEO Jack Dorsey had gathered a team of 18 colleagues for a policy meeting to talk about ways to make the social media service safer for users. The hottest topic under discussion was how to get rid of "dehumanizing speech" even if it doesn't violate Twitter's rules. The service has clear rules forbidding direct threats of violence and some forms of hate speech, but there are no rules prohibiting deception or misinformation.

For days prior to the meeting, Twitter managers and employees had been fervently debating how to adapt and explain the company's policies for what can and cannot be posted on the service. Twitter had been heavily criticized by users and the press for allowing posts

(*continued*)

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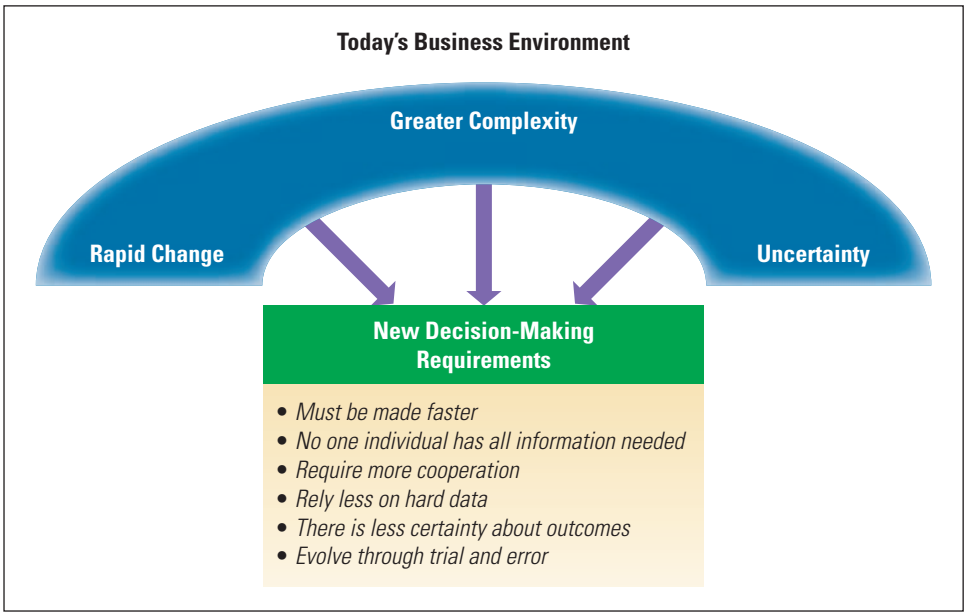
from the far-right conspiracy site Infowars and its creator, Alex Jones, including a post that the Sandy Hook shooting was a hoax. Facebook, Apple, and YouTube pulled videos and podcasts from Infowars and Jones, but Twitter had decided to let the content remain on its site because it did not violate Twitter's rules.

The policy meeting went on for more than an hour, with participants struggling to simply come up with a definition of what constitutes "dehumanizing speech." At one point, Dorsey asked if there might be a technology solution, but there was no agreement on an answer. The team decided to draft a policy about dehumanizing speech and open it to the public for comments and debate. Dealing with the issue of free speech on social media is challenging. Karen Kornbluh, a senior fellow of digital policy at the Council of Foreign Relations, captured Twitter's wicked decision problem when she said, "There is no due process, no transparency, no case law, and no expertise on these very complicated legal and social questions behind these decisions."[10]

Twitter's struggle over what to ban from its site illustrates a wicked problem. Wicked problems are associated with manager conflicts over decision objectives as well as over viable alternatives, rapidly changing circumstances, and unclear linkages among decision elements. Managers dealing with a wicked decision may hit on a solution that merely proves they failed to correctly define the problem to begin with.[11] Organizational scholar Russell Ackoff once said, "Managers don't solve simple, isolated problems. They manage messes." *Messes*, Ackoff explained, involve highly interconnected problems and constantly changing, interdependent circumstances.[12] In other words, a mess is a wicked problem. Under conditions of such extreme uncertainty, even a good choice can produce a bad outcome.[13]

EXHIBIT 13.1
Decision Making in Today's Environment


Today's Business Environment
Greater Complexity
Rapid Change
Uncertainty
New Decision-Making Requirements
• Must be made faster
• No one individual has all information needed
• Require more cooperation
• Rely less on hard data
• There is less certainty about outcomes
• Evolve through trial and error

Source: Based on John P. Kotter, *Leading Change* (Boston, MA: Harvard Business School Press, 1996), 56.

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Managers and organizations are dealing with a higher percentage of nonprogrammed and wicked decisions because of the complex and rapidly changing environment. As outlined in Exhibit 13.1, the rapid pace, complexity, and uncertainty of today's environment creates new demands on decision makers. For one thing, decisions must be made faster than when the environment was more stable. No individual manager has the information needed to make all major decisions, which means good decision making depends on cooperation and information sharing. Decisions rely less on hard data, and there is less certainty about the outcomes. Many decisions evolve through trial and error. For example, Walmart managers eliminated nearly 10 percent of merchandise in an effort to simplify and smarten up cluttered stores and increase sales of higher-value items, but the decision hurt sales. Walmart lost market share for the first time in a decade. Managers then announced a campaign called "It's Back" to showcase the return of about 8,500 items to store shelves and adopted a new motto—"Low prices. Every day. On everything."[14]

REMEMBER THIS

- Managers make decisions every day. Decision making involves the stages of problem identification and problem solution.
- Decisions vary in complexity. Programmed decisions are repetitive and well defined, and procedures exist for solving the problem. Nonprogrammed decisions are unique and poorly defined, and no clear procedure exists for solving the problem.
- Extremely complex nonprogrammed decisions are sometimes called wicked decisions. Wicked decisions are associated with manager conflicts over decision objectives and viable alternatives, rapidly changing circumstances, and unclear linkages among decision elements.

13.2 Individual Decision Making

Individual decision making by managers can be described in two ways. First is the **rational approach**, which suggests an ideal method for how managers should try to make decisions. Second is the **bounded rationality perspective**, which describes how decisions actually have to be made under severe time and resource constraints. The rational approach is an ideal that managers may work toward but rarely reach.

13.2a Rational Approach

The rational approach to individual decision making stresses the need for systematic analysis of a problem followed by choice and implementation in a logical, step-by-step sequence. When eighteenth-century politician and diplomat Benjamin Franklin was faced with a difficult problem, for example, he would divide a sheet of paper into two columns labeled "Pro" and "Con" and write down various reasons for or

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against a particular decision. Over several days Franklin would narrow down the list based on a system of weighting the value of each *pro* or *con* until he reached a determination of the best decision.[15] Charles Darwin tried to use the same process to decide whether he should get married. Under "not marry," he noted benefits of bachelorhood such as enjoying "conversation of clever men at clubs." Under "marry," he included "children (if it please God)" and "charms of music and female chitchat."[16] Perhaps Darwin felt, as Ben Franklin did, that by using this rational approach, he was "less liable to make a rash step."[17] For managers, too, the rational approach was developed to guide individual decision making because many managers were observed to be unsystematic and arbitrary in their approach to organizational decisions.

Although the rational model is an ideal not fully achievable in a manager's real world of uncertainty, complexity, and rapid change, as highlighted in Exhibit 13.1, the model does help managers think about decisions more clearly and rationally. Managers should use systematic procedures to make decisions whenever possible. When managers have a deep understanding of the rational decision-making process, it can help them make better decisions even when there is a lack of clear information. The authors of a popular book on decision making use the example of the U.S. Marines, who have a reputation for handling complex problems quickly and decisively. The Marines are trained to quickly go through a series of mental routines that help them analyze the situation and take action.[18]

According to the rational approach, decision making can be broken down into eight steps, as illustrated in Exhibit 13.2 and demonstrated by department store manager Linda Koslow in the following discussion.[19] Koslow was general manager of the Marshall Field's Oakbrook, Illinois, store before the chain was purchased by Macy's.[20]

1. *Monitor the decision environment.* In the first step, a manager monitors internal and external information that will indicate deviations from planned or acceptable behavior. He or she talks to colleagues and reviews financial statements, performance evaluations, industry indices, competitors' activities, and so forth. For example, during the pressure-packed five-week Christmas season, Linda Koslow checks out competitors, eyeing whether they are marking down merchandise. She also scans printouts of her store's previous day's sales to learn what is or is not moving.
2. *Define the decision problem.* The manager responds to deviations by identifying essential details of the problem: where, when, who was involved, who was affected, and how current activities are influenced. For Koslow, this means defining whether store profits are low because overall sales are less than expected or because certain lines of merchandise are not moving as expected.
3. *Specify decision objectives.* The manager determines what performance outcomes should be achieved by a decision.
4. *Diagnose the problem.* In this step, the manager digs below the surface to analyze the cause of the problem. He or she might gather additional data to facilitate this diagnosis. Understanding the cause enables appropriate treatment. For Koslow at Marshall Field's, the cause of slow sales might be competitors' marking down of merchandise or Marshall Field's failure to display hot-selling items in a visible location.

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EXHIBIT 13.2
Steps in the Rational Approach to Decision Making

5. *Develop alternative solutions.* Before a manager can move ahead with a decisive action plan, he or she must have a clear understanding of the various options available to achieve desired objectives. Scholar and researcher Paul Nutt has studied decisions extensively, and one important insight that emerged from his research is the importance of generating multiple alternatives to attain a successful decision outcome.[21] Deciding with just one available alternative is easy, but more often ineffective. The manager may seek ideas and suggestions from other people. Koslow's alternatives for increasing profits could include buying fresh merchandise, running a sale, or reducing the number of employees.
6. *Evaluate alternatives.* This step may involve the use of statistical techniques or personal experience to gauge the probability of success. The manager assesses the merits of each alternative, as well as the probability that it will achieve the desired objectives.
7. *Choose the best alternative.* This step is when the manager uses his or her analysis of the problem, objectives, and alternatives to select a single alternative that has the best chance for success. At Marshall Field's, Koslow may choose to reduce the number of staff as a way to meet the profit goals rather than increase advertising or markdowns.

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8. *Implement the chosen alternative*. Finally, the manager uses managerial, administrative, and persuasive abilities and gives directions to ensure that the decision is carried out, sometimes called execution of the decision. This might be considered the core of the decision process because any decision that isn't successfully implemented is a failed decision, no matter how good the chosen alternative might be.[22] Managers have to mobilize the people and resources to put the decision into action. Execution may be the hardest step of decision making. The monitoring activity (step 1) begins again as soon as the solution is implemented. For many managers, the decision cycle is a continuous process, with new decisions made daily based on monitoring the environment for problems and opportunities.

The first four steps in this sequence are the problem identification stage, and the next four steps are the problem solution stage of decision making, as indicated in Exhibit 13.2. A manager normally goes through all eight steps in making a decision, although each step may not be a distinct element. Managers may know from experience exactly what to do in a situation, so one or more steps will be minimized. The following example illustrates how the rational approach is used to make a decision about a personnel problem.

IN PRACTICE
Veracruz Consulting

1. *Monitor the decision environment*. It is Monday morning, and Joe Martinez, Veracruz Consulting's accounts receivable supervisor, is absent again.
2. *Define the decision problem*. This is the fourth consecutive Monday Martinez has been absent. Company policy forbids unexcused absenteeism, and Martinez has been warned about his excessive absenteeism on the last two occasions. A final warning is in order but can be delayed, if warranted.
3. *Specify decision objectives*. Martinez should attend work regularly and establish the invoice collection levels of which he is capable. The time period for solving the problem is two weeks.
4. *Diagnose the problem*. Discreet discussions with Martinez's coworkers and information gleaned from Martinez indicate that Martinez has a drinking problem. He apparently uses Mondays to dry out from weekend benders. Discussion with other company sources confirms that Martinez is a problem drinker.
5. *Develop alternative solutions*. (1) Fire Martinez. (2) Issue a final warning without comment. (3) Issue a warning and accuse Martinez of being an alcoholic to let him know you are aware of his problem. (4) Talk with Martinez to see if he will discuss his drinking. If he admits he has a drinking problem, delay the final warning and suggest that he enroll in the company's employee assistance program that offers help with personal problems, including alcoholism. (5) Talk with Martinez to see if he will discuss his drinking. If he does not admit he has a drinking problem, let him know that the next absence will cost him his job.
6. *Evaluate alternatives*. The cost of training a replacement is the same for each alternative. Alternative 1 ignores cost and other criteria. Alternatives 2 and 3 do not adhere to company policy, which advocates counseling where appropriate. Alternative 4 is designed for the benefit of both Martinez and the company. It might save a good employee if Martinez is willing to seek assistance. Alternative 5 is primarily for the benefit of the company. A final warning might provide some incentive for Martinez to admit he has a drinking problem. If so, dismissal might be avoided, but further absences will no longer be tolerated.
7. *Choose the best alternative*. Martinez does not admit that he has a drinking problem. Choose alternative 5.
8. *Implement the chosen alternative*. Write up the case and issue the final warning.[23]

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In the preceding example, issuing the final warning to Joe Martinez was a programmed decision. The standard of expected behavior was clearly defined, information on the frequency and cause of Martinez's absence was readily available, and acceptable alternatives and procedures were described. The rational procedure works best in such cases, when the decision maker has sufficient time for an orderly, thoughtful process. Moreover, Veracruz Consulting had mechanisms in place to successfully implement the decision once it was made.

When decisions are nonprogrammed, ill-defined, and piling on top of one another, the individual manager should still try to use the steps in the rational approach, but he or she often will have to take shortcuts by relying on intuition and experience. Deviations from the rational approach are explained by the bounded rationality perspective.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Use rational decision processes when possible, but recognize that many constraints may impinge on decision makers and prevent a perfectly rational decision. Apply the bounded rationality perspective and use intuition and experience when confronting ill-defined, nonprogrammed decisions.

13.2b Bounded Rationality Perspective

The point of the rational approach is that managers should try to use systematic procedures to arrive at good decisions. When managers are dealing with well-understood issues, they generally use rational procedures to make decisions.[24] Yet research into managerial decision making shows that managers often are unable to follow an ideal procedure. Many decisions must be made very quickly. Time pressure, a large number of internal and external factors affecting a decision, and the ill-defined nature of many problems make systematic analysis virtually impossible. Managers have only so much time and mental capacity and, hence, cannot evaluate every goal, problem, and alternative. The attempt to be rational is bounded (limited) by the enormous complexity of many problems. There is a limit to how much information or knowledge managers can process and how rational they can be.

Bounded rationality should not always be used, but it is useful for certain decisions. *Bounded rationality* is the term coined by organizational scholar Herbert Simon. Simon believed that a perfect solution might exist for a problem, but because of the bounded mind, people are not able to conduct the necessary cognitive steps to reach it.[25] To understand the bounded rationality approach, think about how most new managers select a job upon graduation from college. Even this seemingly simple decision can quickly become so complex that a bounded rationality approach is used. Graduating students typically search for a job until they have two or three acceptable job offers, at which point their search activity rapidly diminishes. Hundreds of firms may be available for interviews, and two or three job offers are far short of the maximum number that would be possible if students made the decision based on perfect rationality.

Constraints and Trade-offs. Not only are large organizational decisions too complex to fully comprehend, but several constraints impinge on the decision maker, as illustrated in Exhibit 13.3. For many decisions, the organizational circumstances are ambiguous, requiring social support, a shared perspective on what happens, and acceptance and agreement. Other organizational constraints on decision making outlined in Exhibit 13.3 include corporate culture and ethical values, as discussed in Chapters 7 and 11, and the organization's structure and design. For example, the corporate culture of BP acted as a constraint on decisions managers made that contributed to the disastrous Deepwater Horizon explosion and oil spill in the Gulf of Mexico. Taking risky shortcuts was deeply ingrained into the culture of

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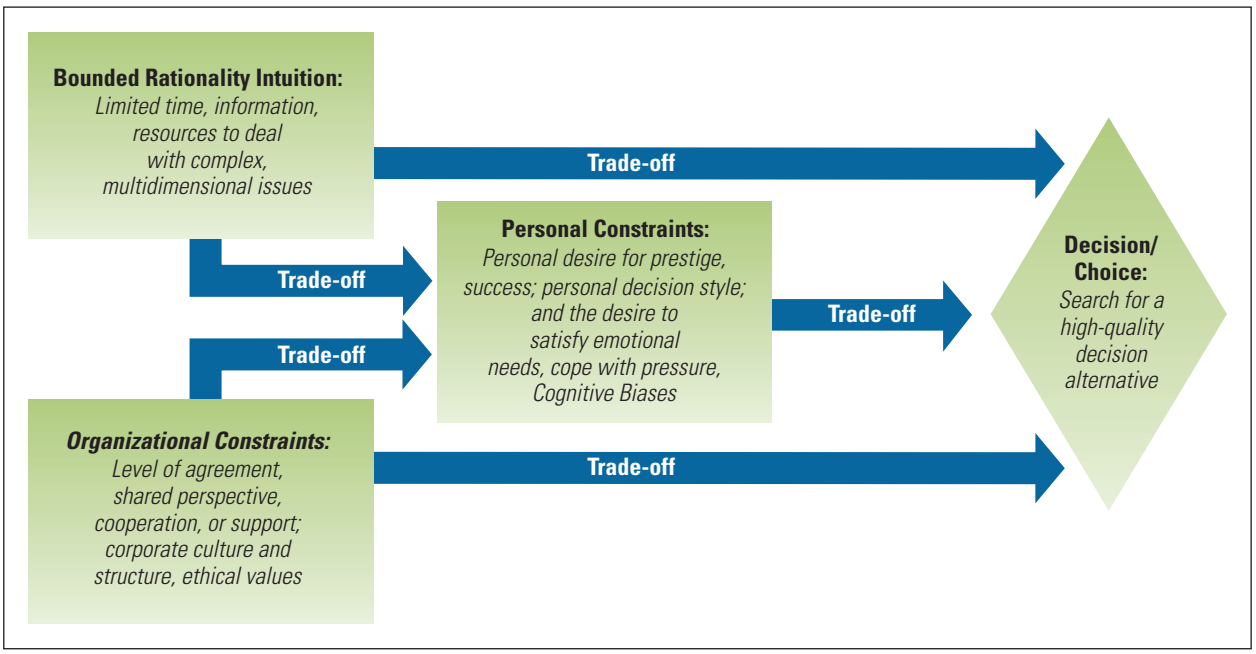
the company. BP was drilling one of the deepest oil wells in history, for example, but managers decided to use only one strand of steel casing instead of the recommended two or more. Rather than using the recommended 21 centralizers, which ensure that the well doesn't veer off course as it drills deeper, BP managers decided to use only six. They also skipped a crucial test to verify the sturdiness of the cement holding the well at the bottom of the sea, deciding instead to depend solely on the blowout preventer as a safeguard. Most oil companies typically build in additional safeguards so problems can be fixed before the blowout preventer is needed, but BP's aggressive, risk-taking culture constrained managers from taking the more cautious and time-consuming approach.[26]

Constraints also exist at the personal level. Personal constraints—such as decision style, work pressure, desire for prestige, or simple feelings of insecurity—may constrain either the search for alternatives or the acceptability of an alternative. All of these factors constrain a perfectly rational approach that should lead to an obviously ideal choice.[27] For example, Art Peck, CEO of Gap Inc., reportedly has an analytical decision style and favors data and analysis over creative decision making. Some people think his decision to give more power to operational executives instead of creative executives has hampered Gap's ability to adapt to changes in the fashion retail industry, but Peck says, "There is now science and art, and they can come together."[28] Some managers make many of their decisions within a mindset of trying to please upper managers, people who are perceived to have power within the organization, or others they respect and want to emulate.[29] Other managers are constrained by a less adaptive decision style.

EXHIBIT 13.3
Constraints and Trade-offs During Nonprogrammed Decision Making


Bounded Rationality Intuition:
Limited time, information, resources to deal with complex, multidimensional issues
Trade-off
Trade-off
Trade-off
Personal Constraints:
Personal desire for prestige, success; personal decision style; and the desire to satisfy emotional needs, cope with pressure, Cognitive Biases
Trade-off
Decision/ Choice:
Search for a high-quality decision alternative
Organizational Constraints:
Level of agreement, shared perspective, cooperation, or support; corporate culture and structure, ethical values
Trade-off

Source: Adapted from Irving L. Janis, *Crucial Decisions* (New York: Free Press, 1989); and Alexander L. George, *Presidential Decision Making in Foreign Policy: The Effective Use of Information and Advice* (Boulder, CO: Westview Press, 1980).

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In addition, many managers have biases that cloud their judgment and act as constraints when making decisions. The next section will discuss cognitive biases in detail.

The Role of Intuition. The bounded rationality perspective is often associated with intuitive decision processes. In **intuitive decision making**, experience and judgment rather than sequential logic or explicit reasoning are used to make decisions.[30] Most researchers have found that effective managers use a combination of rational analysis and intuition in making complex decisions under time pressure.[31] Go to the "How Do You Fit the Design?" box for some insight into your use of rationality versus intuition in making decisions.

HOW DO YOU FIT THE DESIGN?

MAKING IMPORTANT DECISIONS

How do you make important decisions? To find out, think about a time when you made an important career decision or made a major purchase or investment. To what extent does each of the following words describe how you reached the final decision? Please check five words that best describe how you made your final choice.

1. Logic _____
2. Inner knowing _____
3. Data _____
4. Felt sense _____
5. Facts _____
6. Instincts _____
7. Concepts _____
8. Hunch _____
9. Reason _____
10. Feelings _____

Scoring: Give yourself one point for each odd-numbered item you checked, and subtract one point for each even-numbered item you checked. The highest possible score is +5 and the lowest possible score is –5.

Interpretation: The odd-numbered items pertain to a linear decision style and the even-numbered items pertain to a nonlinear decision approach. Linear means using logical *rationality* to make decisions, which would be similar to the decision process in Exhibit 13.2. Nonlinear means using primarily *intuition* to make decisions, as described in the text. If you scored from +3 to –5, then intuition and a satisficing model is your dominant approach to major decisions. If you scored from +3 to +5, then the rational model of decision making as described in the text is your dominant approach. The rational approach is taught in business schools, but many managers use intuition based on experience, especially at senior management levels when there is little tangible data to evaluate.

Source: Adapted from Charles M. Vance, Kevin S. Groves, Yongsun Paik, and Herb Kindler, "Understanding and Measuring Linear–Nonlinear Thinking Style for Enhanced Management Education and Professional Practice," *Academy of Management Learning & Education* 6, no. 2 (2007), 167–185.

Intuition has been defined as "our mind's ability to understand something without the need for conscious reasoning."[32] Intuition is not arbitrary or irrational because it is based on years of practice and hands-on experience, often stored in the subconscious. When managers use their intuition based on long experience with organizational issues, they more rapidly perceive and understand problems, and they develop a gut feeling or hunch about which alternative will solve a problem,

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speeding the decision-making process.[33] The value of intuition for effective decision making is supported by a growing body of research from psychology, organizational science, and other disciplines.[34]

When someone has a depth of experience and knowledge in a particular area, the right decision often comes quickly and effortlessly because the individual recognizes patterns based on information that has been largely forgotten by the conscious mind. This ability could be seen among soldiers in Iraq who were responsible for stopping many roadside bomb attacks by recognizing patterns. High-tech gear designed to detect improvised explosive devices, or IEDs, was merely a supplement rather than a replacement to the ability of the human brain to sense danger and act on it. Soldiers with experience in Iraq unconsciously knew when something didn't look or feel right. It might be a rock that wasn't there yesterday, a piece of concrete that looked too symmetrical, odd patterns of behavior, or just a different feeling of tension in the air.[35] Similarly, in the business world, managers continuously perceive and process information that they may not consciously be aware of, and their base of knowledge and experience helps them make decisions that may be characterized by uncertainty and ambiguity.

Managers use previous experience and judgment to incorporate intangible elements at both the problem identification and problem solution stages.[36] A study of manager problem finding showed that 30 of 33 problems were ambiguous and ill-defined.[37] Bits and scraps of unrelated information from informal sources resulted in a pattern in the manager's mind. The manager could not prove a problem existed but knew intuitively that a certain area needed attention. A too-simple view of a complex problem is often associated with decision failure,[38] so managers learn to listen to their intuition rather than accepting that things are going okay.

Intuitive processes are also used in the problem solution stage. Executives frequently make decisions without explicit reference to the impact on profits or to other measurable outcomes.[39] As we saw in Exhibit 13.3, many intangible factors—such as a person's concern about the support of other executives, fear of failure, and social attitudes—influence selection of the best alternative. These factors cannot be quantified in a systematic way, so intuition guides the choice of a solution. Managers may make a decision based on what they sense to be right rather than on what they can document with hard data.

ASSESS YOUR ANSWER

1 Managers should use the most objective, rational process possible when making a decision.

ANSWER: *Disagree.* Striving for perfect rationality in decision making is ideal but not realistic. Many complex decisions do not lend themselves to a step-by-step analytical process. There are also numerous constraints on decision makers. When making nonprogrammed decisions, managers may try to follow the steps in the rational decision-making process, but they also rely on experience and intuition.

This chapter's BookMark discusses how managers can give their intuition a better chance of leading to successful decisions. Remember that the bounded rationality perspective and the use of intuition apply mostly to nonprogrammed decisions. The novel, unclear, complex aspects of nonprogrammed decisions

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mean hard data and logical procedures are not available. Studies of executive decision making find that managers simply cannot use the rational approach for nonprogrammed strategic decisions, such as whether to market a controversial new prescription drug, whether to invest in a complex new project, or whether a city has a need for and can reasonably adopt an enterprise resource planning system.[40] For decisions such as these, managers have limited time and resources, and some factors simply cannot be measured and analyzed. Trying to quantify such information could cause mistakes because it may oversimplify decision criteria. Intuition can balance and supplement rational analysis to help managers make better decisions. A new trend in decision making is referred to as **quasirationality**, which basically means combining intuitive and analytical thought.[41] There are many situations in which neither analysis nor intuition is sufficient for making a good decision, so managers use a combination of processes.

BOOKMARK 13.0 HAVE YOU READ THIS BOOK?

Blink: The Power of Thinking Without Thinking

By Malcolm Gladwell

Snap decisions can be just as good as—and sometimes better than—decisions that are made cautiously and deliberately. Yet they can also be seriously flawed or even dangerously wrong. That's the premise of Malcolm Gladwell's *Blink: The Power of Thinking Without Thinking*. Gladwell explores how our *adaptive unconscious* arrives at complex, important decisions in an instant—and how we can train it to make those decisions good ones.

SHARPENING YOUR INTUITION

Even when we think our decision making is the result of careful analysis and rational consideration, Gladwell says, most of it actually happens subconsciously in a split second. This process, which he refers to as *rapid cognition*, provides room for both amazing insight and grave error. Here are some tips for improving rapid cognition:

- *Remember that more is not better.* Gladwell argues that giving people too much data and information hampers their ability to make good decisions. He cites a study showing that emergency room doctors who are best at diagnosing heart attacks gather less information from their patients than other doctors do. Rather than overloading on information, search out the most meaningful parts.
- *Practice thin-slicing.* The process Gladwell refers to as *thin-slicing* is what harnesses the power of the adaptive unconscious and enables us to make smart decisions with minimal time and information. Thin-slicing means focusing on a thin slice of pertinent data or information and allowing your intuition to do the work for you. Gladwell cites the example of a Pentagon war game, in which an enemy team of commodities traders defeated a U.S. Army that had "an unprecedented amount of information and intelligence" and "did a thoroughly rational and rigorous analysis that covered every conceivable contingency." The commodities traders were used to making thousands of instant decisions an hour based on limited information. Managers can practice spontaneous decision making until it becomes second nature.
- *Know your limits.* Not every decision should be based on intuition. When you have a depth of knowledge and experience in an area, you can put more trust in your gut feelings. Gladwell also cautions to beware of biases that interfere with good decision making. *Blink* suggests that we can teach ourselves to sort through first impressions and figure out which are important and which are based on subconscious biases such as stereotypes or emotional baggage.

PUT IT TO WORK

Blink is filled with lively and interesting anecdotes, such as how experienced firefighters can "slow down a moment" and create an environment where spontaneous decision making can take place. Gladwell asserts that a better understanding of the process of split-second decision making can help people make better decisions in all areas of their lives, as well as help them anticipate and avoid miscalculations.

Blink: The Power of Thinking Without Thinking, by Malcolm Gladwell, is published by Little Brown.

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REMEMBER THIS

- The rational approach describes an ideal method for how managers should try to make decisions. Steps in the rational approach include monitoring the decision environment, defining the problem, specifying decision objectives, diagnosing the problem, developing alternatives, evaluating alternatives, choosing the best alternative, and implementing the chosen solution.
- Most organizational decisions are not made in a logical, rational manner. Most decisions do not begin with the careful analysis of a problem, followed by systematic analysis of alternatives, and finally implementation of a solution. On the contrary, decision processes are characterized by conflict, coalition building, trial and error, speed, and mistakes.
- Managers also operate under many constraints that limit rationality; hence, they use satisficing and intuition as well as rational analysis in their decision making.

13.3 Cognitive Biases

A customer of a global financial services firm accidentally submitted the same application to two offices. The employees in each office had the same corporate-issued guidelines they were supposed to follow, so they should have arrived at similar results. But that isn't what happened. Employees at the different offices returned very different quotes, even though they were using the same data and guidelines. Managers at the customer's firm were so irked by receiving two radically different quotes that they gave their business to a competitor.[42] Decisions are made by human beings, and the human factor can strongly affect how a problem is defined and how it is solved.

There are numerous factors that can influence how someone considers and solves a problem. Cognitive biases are one significant factor that managers should be aware of. Everyone has biases, but most of us have a hard time seeing our own. Before reading the rest of this chapter, answer the questions in Exhibit 13.4 to see if you let biases affect your decisions.

EXHIBIT 13.4
Do Biases Influence Your Decision Making?

Answer the questions below before reading the rest of the chapter:

1. A piece of paper is folded in half, in half again, and so forth. After 100 folds, how thick will it be? Take your best guess: _____. I am 90 percent sure that the correct answer lies between _____ and _____.
2. A compulsive smoker wakes up at 2:00 AM and out of cigarettes. No stores are open. He searches through the waste paper baskets and ashtrays for butts, knowing that with five butts he can roll a new cigarette. He finds 25 butts, enough to last him as he smokes one cigarette every hour. How long does his supply last? The number of hours is _____.
3. Which figure below is most different from the others?

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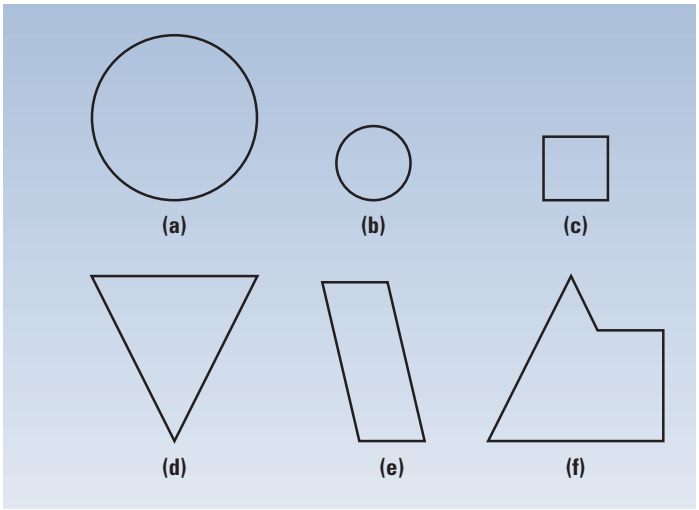

4. As owner and CEO of your company, you decided to invest $100 million to build pilotless drones that cannot be detected by enemy radar. When the project is 90 percent complete, a competing firm begins marketing a completed drone that cannot be detected by radar. In addition, their drone is much faster, smaller, cheaper, and more sophisticated than the drone your company is developing. The question is: Should you invest the last 10 percent of the research funds to finish your drone? Check one answer below.

   _____ No—There is no reason to continue spending money on the project.

   _____ Yes—After investing $90 million, we might as well finish the project.

5. Give a quick (five-second) estimate of the following product without actually calculating:

   8 x 7 x 6 x 5 x 4 x 3 x 2 x 1 = _____.

6. How many times does the letter "f" appear in the following sentence?

   These finished files have been developed after years of scientific investigation of administrative phenomena, combined with the fruit of long experience on the part of the two investigators who have come forward with them for our meeting today.
   The letter "f" appears _____ times.

7. Robert is envious, stubborn, critical, impulsive, industrious, and intelligent. In general, how emotional do you think Robert is? (Circle one number.)

   Not emotional at all 1 2 3 4 5 6 7 8 9 Extremely emotional

8. Which would you choose between the two alternatives below?

   _____ Alternative A: A 50 percent chance of gaining $1,000.00
   _____ Alternative B: A sure gain of $500.00

   Which would you choose between the two alternatives below?

   _____ Alternative C: A 50 percent chance of losing $1000.00
   _____ Alternative D: A sure loss of $500.00

After you have specified an answer to each problem, you will find the answers and a description of the potential related bias at the end of this chapter.

Sources: Questions 1 and 4–8 are from research studies reviewed in Scott Plous, *The Psychology of Judgment and Decision Making* (Philadelphia: Temple University Press, 1993). Question 2 is adapted from Eugene Raudsepp with George P. Hough, Jr, *Creative Growth Games* (New York: Perigee Books, 1977). Question 3 is based on an item in the Creativity in Action Newsletter as reported in Arthur B. VanGundy, *Idea Power: Techniques & Resources to Unleash the Creativity in Your Organization* (New York: Amacon, 1992).

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13.3a Specific Biases That May Influence Decision Making

Cognitive biases are severe errors in judgment that all humans are prone to and that typically lead to bad choices.[43] Awareness of the following biases can help you make better decisions as a manager as well as in your personal life.[44]

1. *Being influenced by initial impressions.* When considering decisions, the mind often gives disproportionate weight to the first information it receives. This is called the anchoring effect. These initial impressions, statistics, or estimates act as an anchor to our subsequent thoughts and judgments. Anchors can be as simple as a random comment by a colleague or a statistic read on a website. Past events and trends also act as anchors. For example, in business organizations, managers frequently look at the previous year's sales when estimating sales for the coming year. Giving too much weight to the past can lead to poor forecasts and misguided decisions.
2. *Seeing what you want to see.* People frequently look for information that supports their existing instinct or point of view and avoid information that contradicts it. This bias affects where managers look for information, as well as how they interpret the information they find. People tend to give too much weight to supporting information and too little to information that conflicts with their established viewpoints.
3. *Being influenced by emotions.* If you've ever made a decision when you were angry, upset, unhappy, or even very happy, you might already know the danger of being influenced by emotions. A study of traders in London investment banks found that effective regulation of emotions was a characteristic of higher-performing traders. Lower-performing traders were less effective in managing and modulating their emotional responses.[45] Another finding is that doctors make less effective decisions when they feel emotions of like or dislike for a patient. If they like a patient, they are less likely to prescribe a painful procedure. If they feel dislike, they may blame the patient for the condition and provide less treatment.[46] To keep emotion from clouding their judgment regarding patient care, doctors in the Partners Health Care System incorporated the use of clinical decision support systems based on reams of data about what works and what doesn't.[47] Organization managers make better decisions when—to the extent possible—they take emotions out of the decision-making process.
4. *Being overconfident.* Most people overestimate their ability to predict uncertain outcomes. A manager at a fast-food chain was sure that low employee turnover was a key driver of customer satisfaction and store profitability, so he decided to invest in programs to keep employees happy. However, when managers analyzed store data, they found that some locations with high turnover were highly profitable, while some with low turnover were struggling.[48] Overconfidence can be particularly dangerous when making risky decisions.
5. *Escalating commitment.* One well-known cognitive bias is referred to as **escalating commitment**. Research suggests that organizations often continue to invest time and money in a solution despite strong evidence that it is not working.[49] Many times managers simply keep hoping they can recoup their losses. For example, after the Fukushima Daiichi nuclear power plant was damaged by an earthquake in Japan, managers at Tokyo Electric Power Company delayed using seawater to cool the damaged nuclear reactors because they wanted to protect their investment and knew that using seawater could

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render the reactors permanently inoperable.[50] Another explanation is that consistency and persistence are valued in contemporary society. Consistent managers are considered better leaders than those who switch around from one course of action to another, so managers have a hard time pulling the plug despite evidence that a decision was wrong.

6. *Fearing failure or loss*. Typically, people hate losing more than they enjoy winning, which is referred to as *loss aversion*. Because of this, the fear of failure is more powerful than the opportunity for success when making a decision.[51] The pain one feels from losing a 20-dollar bill is typically much more powerful than the happiness one gets from finding one. **Prospect theory**, developed by psychologists Daniel Kahneman and Amos Tversky, suggests that the threat of a loss has a greater impact on a decision than the possibility of an equivalent gain.[52] Therefore, most managers have a tendency to analyze problems in terms of what they fear losing rather than what they might gain. When faced with a specific decision, they overweight the value of potential losses and underweight the value of potential gains. In addition, research indicates that the regret associated with a decision that results in a loss is stronger than the regret of a missed opportunity. Thus, managers might avoid potentially wonderful opportunities that also have potentially negative outcomes. This tendency can create a pattern of overly-cautious decisions that leads to chronic underperformance in the organization.[53] Prospect theory also helps explain the phenomenon of escalating commitment, discussed above. Managers don't want to lose or be associated with a failing project, so they keep throwing good money after bad.
7. *Being influenced by the group*. Many decisions in organizations are made by groups, and the desire to go along with the group can bias decisions. Subtle pressures for conformity exist in almost any group, and particularly when people like one another, they tend to avoid anything that might create disharmony. **Groupthink** refers to the tendency of people in groups to suppress contrary opinions.[54] When people slip into groupthink, the desire for harmony outweighs concerns over decision quality. Group members emphasize maintaining unity rather than realistically challenging problems and alternatives. People censor their personal opinions and are reluctant to criticize the opinions of others.

BRIEFCASE

As an organization manager, keep this guideline in mind:

Don't let cognitive biases cloud your decision making. To avoid problems such as groupthink, overconfidence, being influenced by emotions, escalating commitment, and being influenced by loss aversion, apply evidence-based management and use techniques to encourage diversity and dissent.

13.3b Overcoming Cognitive Biases

How can managers avoid cognitive biases? Several ideas have been proposed that help managers be more realistic and objective when making decisions. Two of the most effective are to use evidence-based management and to encourage dissent and diversity.

Evidence-Based Management. **Evidence-based management** means a commitment to make more informed and objective decisions based on the best available facts and evidence.[55] It means being aware of one's biases, seeking and examining evidence with rigor. Managers practice evidence-based decision making by being careful and thoughtful rather than carelessly relying on assumptions, past experience, rules of thumb, or intuition when objective data can be found. For example, Dawn Zier was hired as CEO of Nutrisystem to turn things around, but when she would ask people questions, she says "they would answer a little too quickly, without even having time to think about it." When Zier dug deeper, she usually found that "the facts weren't always the facts being presented." Zier embarked on a culture change

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initiative to build a culture where people focus on hard evidence rather than "fantasy or wishing that something happened." The company's motto is now, "Just the Facts," where the word *Facts* stands not only for evidence but also for the values of focus, accountability, customer-centric, team, and success.[56]

A global survey by McKinsey & Company found that when managers incorporate thoughtful analysis into decision making, they get better results. Studying the responses of more than 2,000 executives regarding how their companies made a specific decision, McKinsey concluded that techniques such as detailed analysis, risk assessment, financial models, and considering comparable situations typically contribute to better financial and operational outcomes.[57] However, a recent review of the decisions of 39 senior general managers found that they frequently used only limited sources of evidence in making most of their decisions. Managers can enhance the effectiveness of decisions by using more sources of evidence.[58] Evidence-based management can be particularly useful for overcoming the bias of loss aversion and the problem of escalating commitment. Many manager problems are uncertain, and hard facts and data aren't available, but by always seeking evidence, managers can avoid relying on faulty assumptions. Decision makers can also do a post-mortem of decisions to evaluate what worked, what didn't, and how to do things better. The best decision makers have a healthy appreciation for what they don't know. They are always questioning and encouraging others to question their knowledge and assumptions. They foster a culture of inquiry, observation, and experimentation.

Encourage Dissent and Diversity. A primary way to keep people from allowing cognitive biases to influence decisions is to create an organizational environment in which people feel free to speak up, disagree with others, and challenge ideas and decisions.[59] Dissent and diversity can be particularly useful in complex circumstances because they open the decision process to a wide variety of ideas and opinions rather than being constrained by personal biases or groupthink.[60] One way to encourage dissent is to ensure that the group is diverse in terms of age and gender, race and ethnicity, functional area of expertise, hierarchical level, and experience with the business. A social psychologist conducted a series of mock trials in which a jury debated and evaluated evidence from a criminal case and found that racially diverse juries almost always performed better in terms of considering more interpretations of the evidence, remembering details of the case more accurately, and engaging in more rigorous discussion and deliberation.[61] Some groups assign a **devil's advocate**, who has the role of challenging the assumptions and assertions made by the group.[62] The devil's advocate may force the group to rethink its approach to the problem and avoid reaching premature decisions. Consider the situation of soldiers involved in volatile military operations, where faulty decisions could be deadly. At Fort Leavenworth's University of Foreign Military and Cultural Studies, the U.S. Army trained a group of soldiers to act as devil's advocates. Members of the "Red Team," as graduates were called, were deployed to various brigades to question prevailing assumptions and make sure decisions were considered from alternate points of view. Greg Fontenot, the program director, said the goal is to avoid "getting sucked into that groupthink."[63]

Another approach, referred to as *ritual dissent*, puts parallel teams to work on the same problem in a large group meeting. Each team appoints a spokesperson who presents the team's findings and ideas to another team, which is required to listen quietly. Then, the spokesperson turns to face away from the team, which rips into the presentation no-holds-barred while the spokesperson is required to listen

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quietly. Each team's spokesperson does this with every other team in turn, so that by the end of the session all ideas have been well-dissected and discussed.[64] Whatever techniques they use, good managers find ways to get a diversity of ideas and opinions on the table when making complex decisions.

REMEMBER THIS

- Allowing cognitive biases to cloud decision making can have serious negative consequences for an organization.
- Some of the most common biases to guard against are being influenced by initial impressions, being overconfident, being influenced by emotions, seeing what you want to see, escalating commitment, groupthink, and loss aversion.
- Managers can avoid or overcome cognitive biases by using evidence-based management and by encouraging diversity and dissent in the decision-making process.

13.4 Organizational Decision Making

Organizations are composed of managers who make decisions using both rational and intuitive processes, but organization-level decisions are not usually made by a single manager. Many organizational decisions involve several managers. Problem identification and problem solution involve many departments, multiple viewpoints, and even other organizations, which are beyond the scope of an individual manager.

The processes by which decisions are made in organizations are influenced by a number of factors, particularly the organization's own internal structures and the degree of stability or instability of the external environment.[65] Research into organization-level decision making has identified four primary types of organizational decision-making processes: the management science approach, the Carnegie model, the incremental decision model, and the garbage can model.

13.4a Management Science Approach

The **management science approach** to organizational decision making is the analogue to the rational approach by individual managers. Management science came into being during World War II.[66] At that time, mathematical and statistical techniques were applied to urgent, large-scale military problems that were beyond the ability of individual decision makers.

Mathematicians, physicists, and operations researchers used systems analysis to develop artillery trajectories, antisubmarine strategies, and bombing strategies such as salvoing (discharging multiple shells simultaneously). Consider the problem of a battleship trying to sink an enemy ship several miles away. The calculation for aiming the battleship's guns should consider distance, wind speed, shell size, speed and direction of both ships, pitch and roll of the firing ship, and curvature of the earth. Methods for performing such calculations using trial and error and intuition are not accurate, take far too long, and may never achieve success.

BRIEFCASE

As an organization manager, keep this guideline in mind:

Use a rational decision approach—computation and management science—when a problem situation is well understood and can be broken down into variables that can be measured and analyzed.

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This is where management science came in. Analysts were able to identify the relevant variables involved in aiming a ship's guns and could model them with the use of mathematical equations. Distance, speed, pitch, roll, shell size, and so on could be calculated and entered into the equations. The answer was immediate, and the guns could begin firing. Factors such as pitch and roll were soon measured mechanically and fed directly into the targeting mechanism. Today, the human element is completely removed from the targeting process. Radar picks up the target, and the entire sequence is computed automatically.

Management science yielded astonishing success for many military problems. This approach to decision making diffused into corporations and business schools, where techniques were studied and elaborated. Operations research departments use mathematical models to quantify relevant variables and develop a quantitative representation of alternative solutions and the probability of each one solving the problem. These departments also use such devices as linear programming, Bayesian statistics, PERT charts, and computer simulations.

Management science is an excellent device for organizational decision making when problems are analyzable and when the variables can be identified and measured. Mathematical models can contain a thousand or more variables, each one relevant in some way to the ultimate outcome. Management science techniques have been used to correctly solve problems as diverse as finding the right spot for a church camp, test-marketing the first of a new family of products, drilling for oil, and radically altering the distribution of telecommunications services.[67] Other problems amenable to management science techniques are the scheduling of ambulance technicians, turnpike toll collectors, and airline crew members.[68] As described earlier in this chapter, AI is being used to assign project members at Royal Dutch Shell.

Management science, especially with increasingly sophisticated digital technology and software, can accurately and quickly solve problems that have too many explicit variables for adequate human processing. Alaska Airlines has been using management science techniques to make flight decisions since 1980, when Mount St. Helens erupted near the airline's home base and crippled the company for days. A team of aviation and weather experts developed computer models to predict the trajectory of volcanic ash and often enable flights to work around it.[69] As another example, consider school bus routing, which often uses an intuitively efficient approach of travelling to the closest pickup first, then to the next closest, and so on, until all students are picked up. After the Boston Public Schools held a contest offering a prize for improving the efficiency of its bus system, a team of MIT researchers created an algorithm that optimizes bus routing and drops as many as 75 routes, which the school system says could save up to $5 million, 20,000 pounds of carbon emissions a day, and one million bus miles each year.[70]

Managers in other types of organizations are also applying technology to make more decisions. At Walt Disney World in Orlando, Florida, managers use sophisticated computerized systems to analyze data and make decisions that minimize wait times for visitors, maximize ride capacity, optimize staffing efficiency, and increase souvenir-selling opportunities.[71] Even doctors' offices are turning to management science to manage their practices more efficiently, such as by predicting demand for appointments based on the number of patients in their practice, the average no-show rate, and other factors.[72]

One problem with the management science approach is that quantitative data are not rich and do not convey tacit knowledge, as described in Chapter 9. Informal cues that indicate the existence of problems have to be sensed on a more personal basis by managers.[73] The most sophisticated mathematical analyses

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are of no value if the important factors cannot be quantified and included in the model. Such things as competitor reactions, consumer tastes, and product warmth are qualitative dimensions. In these situations, the role of management science is to supplement manager decision making. Quantitative results can be given to managers for discussion and interpretation along with their informal opinions, judgment, and intuition, in line with a quasirationality approach. The final decision can include both qualitative factors and quantitative calculations.

BRIEFCASE

As an organization manager, keep this guideline in mind:

Use a coalition-building approach when organizational goals and problem priorities are in conflict. When managers disagree about priorities or the true nature of the problem, they should discuss and seek agreement about priorities.

13.4b Carnegie Model

The **Carnegie model** of organizational decision making is based on the work of Richard Cyert, James March, and Herbert Simon, who were all associated with Carnegie Mellon University.[74] Their research helped formulate the bounded rationality approach to individual decision making, as well as provide new insights about organizational decisions.

Until their work, research in economics assumed that business firms made decisions as a single entity, as if all relevant information were funneled to the top decision maker for a choice. Research by the Carnegie group indicated that organization-level decisions involved many managers and that a final choice was based on a coalition among those managers. A **coalition** is an alliance among several managers who agree about organizational goals and problem priorities.[75] For example, top managers at Procter & Gamble came together on a decision to raise prices on some of the company's biggest brands like Pampers diapers and Bounty paper towels.[76] Depending on the decision problem, a coalition might include managers from line departments, staff specialists, and even external groups, such as powerful customers, bankers, or union representatives.

Management coalitions are needed during decision making for two reasons. First, organizational goals are often ambiguous, and operative goals of departments are often inconsistent. When goals are ambiguous and inconsistent, managers disagree about problem priorities. They must bargain about problems and build a coalition around the question of which problems to address. Randy Komisar, a partner with Kleiner Perkins, advises using a technique called "the balance sheet" when a company is facing decisions about which new opportunities to invest in or which problems to solve. Managers from across departments sit around a table, and each person lists on paper the good and bad points about a specific opportunity. This is similar to the "Pro" and "Con" list Benjamin Franklin used for making rational decisions as an individual. In this case, though, managers then share their thoughts and ideas with others and typically find shared interests. The process "mitigates a lot of the friction that typically arises when people marshal the facts that support their case while ignoring those that don't," Komisar says.[77]

The second reason for coalitions is that individual managers intend to be rational but function with human cognitive limitations and other constraints, as described earlier. Managers do not have the time, resources, or mental capacity to identify all dimensions and to process all information relevant to a decision. These limitations lead to coalition-building behavior. Managers talk to each other and exchange points of view to gather information and reduce ambiguity. People who have relevant information or a stake in a decision outcome are consulted. Building a coalition will lead to a decision that is supported by interested parties. Managers at *The New York Times* built a coalition around the decision to begin a paid subscription plan for the newspaper's website.

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IN PRACTICE
The New York Times

The decision to ask readers to begin paying for online access to *The New York Times* wasn't made lightly. In fact, executives and senior editors spent about a year debating the question, analyzing various options, and reaching agreement to implement the new subscription plan.

Arthur Sulzberger, Jr, chairman of the company, and several other top executives embraced the idea of a pay model. However, other senior managers and editors vehemently opposed the plan. These managers and editors had spent years working to build *NYTimes.com* into the most visited newspaper site in the world. They argued that a subscription model would jeopardize the paper's online reach and was out of step with the digital age. Some advertising managers were worried that it would also jeopardize digital advertising revenues. Others argued that the paper needed a subscription source of revenue or more layoffs would be needed.

Debate and discussion continued, both formally and informally. Eventually, a coalition came together around the idea of a tiered subscription service that would allow website visitors to read a certain number of articles each month at no charge, before being asked to select one of three subscription models at various price levels. Articles that people accessed through social networks such as Facebook and Twitter or search engines such as Google would not count toward the monthly limit, which helped to assuage some of the concerns from digital managers and get them on board to support the decision.[78]

The decision to charge for access has been a big help to *The Times* revenue.[79] By successfully building a coalition to support the decision within the organization, managers improved the chances of success. Compare the successful coalition building at *The New York Times* to what happened at Univision Communications, where top leaders and board members have continually clashed over nearly every aspect of determining the company's future direction. At one Univision board meeting, the company's chairman and its CEO got into such a loud shouting match that employees could hear them on the floor below. The CEO later screamed at board members, "I can't take this. . . I quit! I quit!" Like most media companies, Univision, the largest Spanish-language broadcasting outlet in the United States, is facing tough challenges. Amid the ongoing discord and drama, executives have had a tough time building a coalition that can take the company in a positive direction.[80]

The process of coalition building has several implications for organizational decision behavior. First, decisions are made to *satisfice* rather than to optimize problem solutions. **Satisficing** means organizations accept a satisfactory rather than a maximum level of performance, enabling them to achieve several goals simultaneously. In decision making, the coalition will accept a solution that is perceived as satisfactory to all coalition members, as at *The New York Times*.

Second, managers are concerned with immediate problems and short-run solutions. They engage in what Cyert and March called *problemistic search*.[81] **Problemistic search** means managers look around the immediate environment for a solution to quickly resolve a problem. Although managers at *The Times* studied various options that were being used by other companies, they didn't consider every possible approach that could be taken to an online subscription model. Managers don't expect a perfect solution when the situation is ill-defined and conflict-laden. This contrasts with the management science approach, which assumes that analysis

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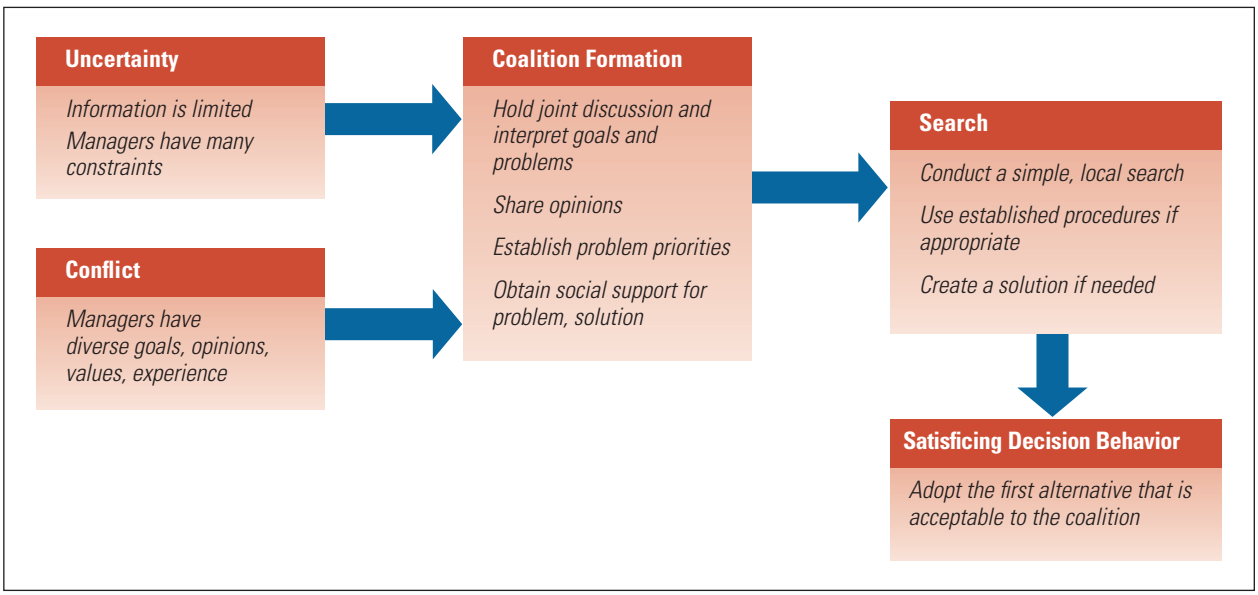
can uncover every reasonable alternative. The Carnegie model says that search behavior is just sufficient to produce a satisfactory solution and that managers typically adopt the first satisfactory solution that emerges.

Third, discussion and bargaining are especially important in the problem identification stage of decision making. Unless coalition members perceive a problem, action will not be taken. However, a coalition of key managers is also important for smooth implementation of a decision. For example, Eric McNulty, the director of research at the National Preparedness Leadership Initiative, described observing a law enforcement official make an important decision during a high-profile criminal investigation. The official had the authority to make the decision on his own, but he chose to work toward a consensus among the leaders of all the agencies involved in the investigation. By using a coalition-building approach, the official both avoided possible blind spots and biases as well as ensured that the ultimate decision was carried through successfully.[82] When top managers perceive a problem or want to make a major decision, they need to reach agreement with other managers to support the decision.[83]

The decision process described in the Carnegie model is summarized in Exhibit 13.5. The Carnegie model points out that building agreement through a managerial coalition is a major part of organizational decision making. This is especially true at upper management levels. Discussion and bargaining are time consuming, so search procedures are usually simple and the selected alternative satisfices rather than optimizes problem solution. When problems are programmed—are clear and have been seen before—the organization will rely on previous procedures and routines. Rules and procedures prevent the need for renewed coalition formation and political bargaining. Nonprogrammed decisions, however, require bargaining and conflict resolution.

EXHIBIT 13.5
Choice Processes in the Carnegie Model


Uncertainty
Information is limited
Managers have many constraints
Conflict
Managers have diverse goals, opinions, values, experience
Coalition Formation
Hold joint discussion and interpret goals and problems
Share opinions
Establish problem priorities
Obtain social support for problem, solution
Search
Conduct a simple, local search
Use established procedures if appropriate
Create a solution if needed
Satisficing Decision Behavior
Adopt the first alternative that is acceptable to the coalition

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ASSESS YOUR ANSWER

2 When a manager knows the best solution to a serious organizational problem and has the necessary authority, it is best to simply make the decision and implement it rather than involve other managers in the decision process.

ANSWER: *Disagree.* Few organizational decisions are made by a single manager. Organizational decision making is a social process that combines multiple perspectives. Managers have to talk to one another about problem priorities and exchange opinions and viewpoints to reach agreement. When managers don't build coalitions, important problems may go unsolved and good decisions may fail because other managers don't buy into the decisions and effectively implement them.

13.4c Incremental Decision Model

Henry Mintzberg and his associates at McGill University in Montreal approached organizational decision making from a different perspective. They identified 25 decisions made in organizations and traced the events associated with these decisions from beginning to end.[84] Their research identified each step in the decision sequence. This theory of decision making, called the **incremental decision model**, places less emphasis on the political and social factors described in the Carnegie model but tells more about the structured sequence of activities undertaken from the discovery of a problem to its solution.[85]

Sample decisions in Mintzberg's research included choosing which jet aircraft to acquire for a regional airline, developing a new supper club, designing a new container terminal in a harbor, identifying a new market for a deodorant, installing a controversial new medical treatment in a hospital, and firing a star radio announcer.[86] The scope and importance of these decisions are revealed in the length of time taken to complete them. Most of these decisions took more than a year, and one-third of them took more than two years. Most of these decisions were nonprogrammed and required custom-designed solutions.

One discovery from this research is that major organizational choices are usually a series of small choices that combine to produce the major decision. Thus, many organizational decisions are a series of nibbles rather than a big bite. However, managers also use the incremental decision process to make single big decisions. Consider how top leaders of the Los Angeles Rams decided to hire the youngest head coach in NFL history.

IN PRACTICE

The Los Angeles Rams

It was a decision that would change the Los Angeles Rams football franchise's future, for better or worse: hiring a new head coach. The Rams owner Stan Kroenke and franchise executives knew the team needed a boost of fresh energy.

Kroenke and leaders including chief operating officer Kevin Demoff and general manager Les Snead first scanned the coaching environment to identify as many desirable candidates as they could, coming up with a list of about 30 names. One name on the list was Sean McVay. *I bet we like this guy a lot, but we'll think he needs more seasoning,* Snead thought. Other leaders were also apprehensive about the alternative of hiring a 30-year-old as head coach. McVay would be 38 years younger than the team's defensive coordinator. "We were looking for something fresh," Kroenke said. "In some ways, I felt like it was a younger man's game. Maybe."

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Leaders began researching the top candidates, including McVay. The more they studied him, the more intrigued they became. They next conducted a broad study of head coach hiring decisions, to see if there was a winning formula for finding the right person. It turned out there wasn't, but the team did discover that some very young coaches proved to be among the most successful ever—while some also proved to be among the least successful. To try to determine if McVay would be a star or a dud, they began talking to everyone they could about him—players and managers and even sports broadcasters.

The interviewing process with McVay took place over a period of eight days. McVay met with Aaron Donald, the Rams' star defensive lineman, and other players. He met with the training staff and the operations staff. Top executives took him to four dinners, including one with their wives, to judge his personality under different circumstances. At the final dinner interview, the leaders asked Hall of Fame running back Marshall Faulk to join the group. "Marshall is a tough audience," Demoff said. "If you can win him over cold, then that spoke to Sean's talent."

The decision to hire Sean McVay turned out to be a good one. Two years later, McVay took the Rams to the Super Bowl, where he was the youngest head coach ever to reach the Super Bowl game and was eight years younger than the quarterback of the opposing team, Tom Brady.[87]

The decision to hire Sean McVay as head coach of the Los Angeles Rams illustrates the series of smaller, sequential decisions and the time-consuming process involved in making a big organizational decision.

In making a big decision, organizations move through several decision points and may hit barriers along the way. Mintzberg called these barriers *decision interrupts*. An interrupt may mean an organization has to cycle back through a previous decision and try something new. Decision loops or cycles are one way the organization learns which alternatives will work. The ultimate solution may be very different from what was initially anticipated.

The pattern of decision stages discovered by Mintzberg and his associates is shown in Exhibit 13.6. Each box indicates a possible step in the decision sequence. The steps take place in three major decision phases: identification, development, and selection.

BRIEFCASE

As an organization manager, keep this guideline in mind:

Take risks and move the company ahead by increments when a problem is defined but solutions are uncertain. Try solutions step by step to learn whether they work.

Identification Phase. The identification phase begins with *recognition*. Recognition means one or more managers become aware of a problem and the need to make a decision. Recognition is usually stimulated by a problem or an opportunity. A problem exists when elements in the external environment change or when internal performance is perceived to be below standard. In the case of firing a radio announcer, comments about the announcer came from listeners, other announcers, and advertisers. Managers interpreted these cues until a pattern emerged that indicated a problem had to be dealt with. In the example of the Los Angeles Rams, they grew dissatisfied with the team's won-lost record and identified the problem as the previous head coach.

The second step is *diagnosis*, in which more information is gathered if needed to define the problem situation. Diagnosis may be systematic or informal, depending upon the severity of the problem. Severe problems do not allow time for extensive diagnosis; the response must be immediate. Mild problems are usually diagnosed in a more systematic manner.

Development Phase. In the development phase, a solution is shaped to solve the problem defined in the identification phase. The development of a solution takes

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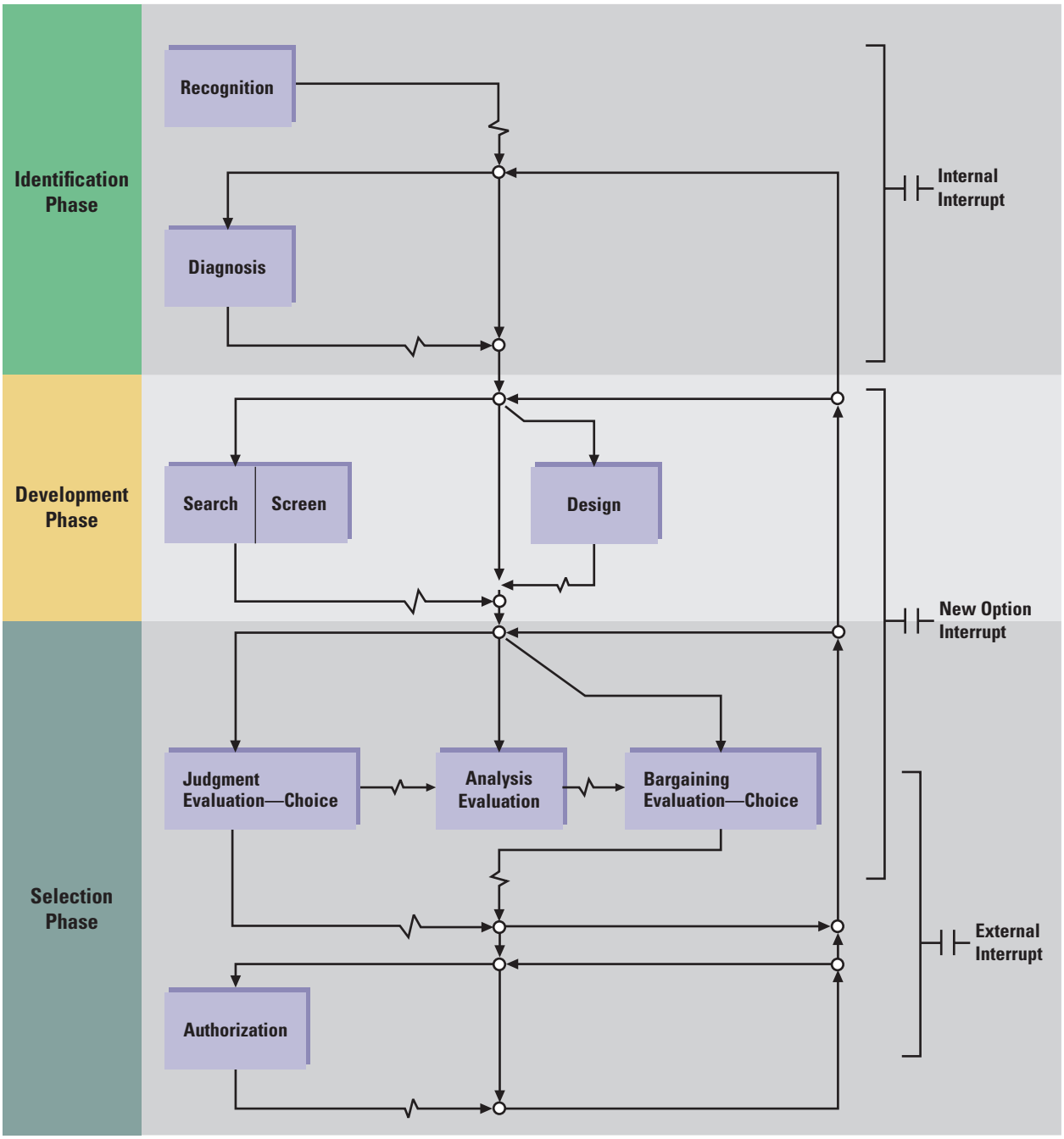
EXHIBIT 13.6
The Incremental Decision Model



Source: Based on Henry Mintzberg, Duru Raisinghani, and André Théorêt, "Structure of Unstructured Decision Processes," *Administrative Science Quarterly* vol. 21(June 1976), 246–275. SAGE Publications.

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one of two directions. First, *search* procedures may be used to seek out alternatives within the organization's repertoire of solutions. In the case of firing a star announcer, for example, managers asked what the radio station had done the last time an announcer had to be let go. To conduct the search, organization participants may look into their own memories, talk to other managers, or examine the formal procedures of the organization. In the case of the Rams, executives identified a list of 30 potential head coach prospects.

The second direction of development is to *design* a custom solution. This happens when the problem is novel so that previous experience has no value. Mintzberg found that in these cases, key decision makers have only a vague idea of the ideal solution. Gradually, through a trial-and-error process, a custom-designed alternative will emerge. Development of the solution is a groping, incremental procedure, building a solution brick by brick.

Selection Phase. The selection phase is when the solution is chosen. This phase is not always a matter of making a clear choice among alternatives. In the case of custom-made solutions, selection is more an evaluation of the single alternative that seems feasible.

Evaluation and choice may be accomplished in three ways. The *judgment* form of selection is used when a final choice falls upon a single decision maker, and the choice involves judgment based upon experience. In *analysis*, alternatives are evaluated on a more systematic basis, such as with management science techniques. Mintzberg found that most decisions did not involve systematic analysis and evaluation of alternatives. *Bargaining* occurs when selection involves a group of decision makers. Each decision maker may have a different stake in the outcome, so conflict emerges. Discussion and bargaining occur until a coalition is formed, as in the Carnegie model described earlier.

When a decision is formally accepted by the organization, *authorization* takes place. The decision may be passed up the hierarchy to the responsible hierarchical level. Authorization is often routine because the expertise and knowledge rest with the lower-level decision makers who identified the problem and developed the solution. A few decisions may be rejected because of implications not anticipated by lower-level managers.

Dynamic Factors. Note that the right-hand side of the chart in Exhibit 13.6 shows lines running back toward the beginning of the decision process. These lines represent loops or cycles that take place in the decision process. Organizational decisions do not follow an orderly progression from recognition through authorization. Minor problems arise that force a loop back to an earlier stage. These are decision interrupts. If a custom-designed solution is perceived as unsatisfactory, the organization may have to go back to the very beginning and reconsider whether the problem is truly worth solving. Feedback loops can be caused by problems of timing, politics, disagreement among managers, inability to identify a feasible solution, turnover of managers, or the sudden appearance of a new alternative. For example, when a small Canadian airline made the decision to acquire jet aircraft, the board authorized the decision, but shortly after, a new chief executive was brought in who canceled the contract, recycling the decision back to the identification phase. He accepted the diagnosis of the problem but insisted upon a new search for alternatives. Then a foreign airline went out of business and two used aircraft became available at a bargain price. This presented an unexpected option, and the chief executive used his own judgment to authorize the purchase of the aircraft.[88]

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Because most decisions take place over an extended period of time, circumstances change. Decision making is a dynamic process that may require a number of cycles before a problem is solved.

REMEMBER THIS

- Individual managers make decisions, but most organizational decisions are not made by a single individual. Organizational decision-making approaches include the management science approach, the Carnegie model, and the incremental decision model.
- Only in rare circumstances do managers analyze problems and find solutions by themselves. Many problems are not clear, so widespread discussion and coalition building take place.
- The greatest amount of conflict and coalition building occurs when problems are not agreed on. Priorities must be established to indicate which goals are important and which problems should be solved first. If a manager attacks a problem other people do not agree with, the manager will lose support for the solution to be implemented. Thus, time and activity should be spent building a coalition in the problem identification stage of decision making.
- Once goals and priorities are set, alternatives to achieve those goals can be tried. Often, the solution unfolds as a series of incremental trials that will gradually lead to an overall solution. When a manager does make an individual decision, it is often a small part of a larger decision process. Organizations solve big problems through a series of small steps. A single manager may initiate one step but should be aware of the larger decision process to which it belongs.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Apply both the Carnegie model and the incremental decision model in a situation with high uncertainty about both problems and solutions. Decision making may also employ garbage can procedures. Move the organization toward better performance by proposing new ideas, spending time working in important areas, and persisting with potential solutions.

13.5 Organizational Decisions and Change

At the beginning of this chapter, we discussed how the rapidly changing business environment is creating greater uncertainty for decision makers. Many organizations are marked by a tremendous amount of uncertainty at both the problem identification and problem solution stages. Two approaches to decision making have evolved to help managers cope with this uncertainty and complexity. One approach is to combine the Carnegie and incremental models just described. The second is a unique approach called the garbage can model.

13.5a Combining the Incremental and Carnegie Models

The Carnegie description of coalition building is especially relevant for the problem identification stage. When issues are ambiguous, or if managers disagree about problem severity, discussion, negotiation, and coalition building are needed. The incremental model tends to emphasize the steps used to reach a solution. After managers agree on a problem, the step-by-step process is a way of trying various solutions to see what will work. When problem solution is unclear, a trial-and-error solution may be designed.

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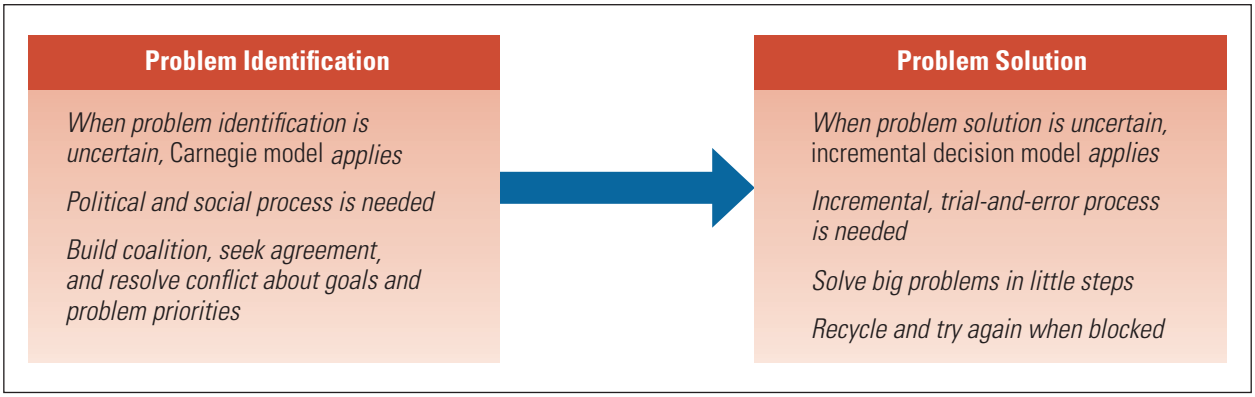
EXHIBIT 13.7
Decision Process When Problem Identification and Problem Solution Are Uncertain


Problem Identification
When problem identification is uncertain, Carnegie model applies
Political and social process is needed
Build coalition, seek agreement, and resolve conflict about goals and problem priorities
Problem Solution
When problem solution is uncertain, incremental decision model applies
Incremental, trial-and-error process is needed
Solve big problems in little steps
Recycle and try again when blocked

The application of the Carnegie and incremental models to the stages in the decision process is illustrated in Exhibit 13.7. The two models do not disagree with one another. They describe different approaches for how organizations make decisions when either problem identification or problem solution is uncertain. When both parts of the decision process are simultaneously highly uncertain, the organization is in an extremely difficult position. Decision processes in that situation may be a combination of the Carnegie and incremental models, and this combination may evolve into a situation described in the garbage can model.

13.5b Garbage Can Model

The **garbage can model** is one of the most recent and interesting descriptions of organizational decision processes. It is not directly comparable to the earlier models, because the garbage can model deals with the pattern or flow of multiple decisions within organizations, whereas the incremental and Carnegie models focus on how a single decision is made. The garbage can model helps you think of the whole organization and the frequent decisions being made by managers throughout. At any time, managers throughout an organization are considering various decisions and actions, such as hiring new employees, developing a new product, or investing in a joint venture. Often, individual managers evaluate alternatives and then top-level executives combine their opinions and suggestions to reach a final decision.[89] Sometimes, however, the decision-making process is much messier.

Organized Anarchy. The garbage can model was developed to explain the pattern of decision making in organizations that experience extremely high uncertainty. Michael Cohen, James March, and Johan Olsen, the originators of the model, called the highly uncertain conditions an **organized anarchy**, which is an extremely organic organization.[90] Organized anarchies do not rely on the normal vertical hierarchy of authority and bureaucratic decision rules. They result from three characteristics:

1. *Problematic preferences.* Goals, problems, alternatives, and solutions are ill-defined. Ambiguity characterizes each step of a decision process.
2. *Unclear, poorly understood technology.* Cause-and-effect relationships within the organization are difficult to identify. An explicit database that applies to decisions is not available.

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3. *Turnover.* Organizational positions experience turnover of participants. In addition, employees are busy and have only limited time to allocate to any one problem or decision. Participation in any given decision will be fluid and limited.

An organized anarchy is characterized by rapid change and a collegial, nonbureaucratic environment. No organization fits this extremely organic circumstance all the time, although today's platform-based companies, as well as organizations in rapidly changing industries, may experience it much of the time. Many organizations will occasionally find themselves in positions of making decisions under unclear, problematic circumstances. The garbage can model is useful for understanding the pattern of these decisions.

Streams of Events. The unique characteristic of the garbage can model is that the decision process is not seen as a sequence of steps that begins with a problem and ends with a solution. Indeed, problem identification and problem solution may not be connected to each other. An idea may be proposed as a solution when no problem is specified. A problem may exist and never generate a solution. Decisions are the outcome of independent streams of events within the organization. The four streams relevant to organizational decision making are as follows:

1. *Problems.* Problems are points of dissatisfaction with current activities and performance. They represent a gap between desired performance and current activities. Problems are perceived to require attention. However, they are distinct from solutions and choices. A problem may lead to a proposed solution or it may not. Problems may not be solved when solutions are adopted.
2. *Potential solutions.* A solution is an idea somebody proposes for adoption. Such ideas form a flow of alternative solutions through the organization. Ideas may be brought into the organization by new personnel or may be invented by existing personnel. Participants may simply be attracted to certain ideas and push them as logical choices regardless of problems. Attraction to an idea may cause an employee to look for a problem to which the idea can be attached and, hence, justified. The point is that solutions exist independent of problems.
3. *Participants.* Organization participants are employees who come and go throughout the organization. People are hired, reassigned, and fired. Participants vary widely in their ideas, perception of problems, experience, values, and training. The problems and solutions recognized by one manager will differ from those recognized by another manager.
4. *Choice opportunities.* Choice opportunities are occasions when an organization usually makes a decision. They occur when contracts are signed, people are hired, or a new product is authorized. They also occur when the right mix of participants, solutions, and problems exists. Thus, a manager who happened to learn of a good idea may suddenly become aware of a problem to which it applies and, hence, can provide the organization with a choice opportunity. Match-ups of problems and solutions often result in decisions.

With the concept of four streams, the overall pattern of organizational decision making takes on a random quality. Problems, solutions, participants, and choices all flow through the organization. In one sense, the organization is a large garbage can in which these streams are being stirred, as illustrated in Exhibit 13.8. When a problem, solution, and participant happen to connect at one point, a decision may be made and the problem may be solved; but if the solution does not fit the problem, the problem may not be solved.

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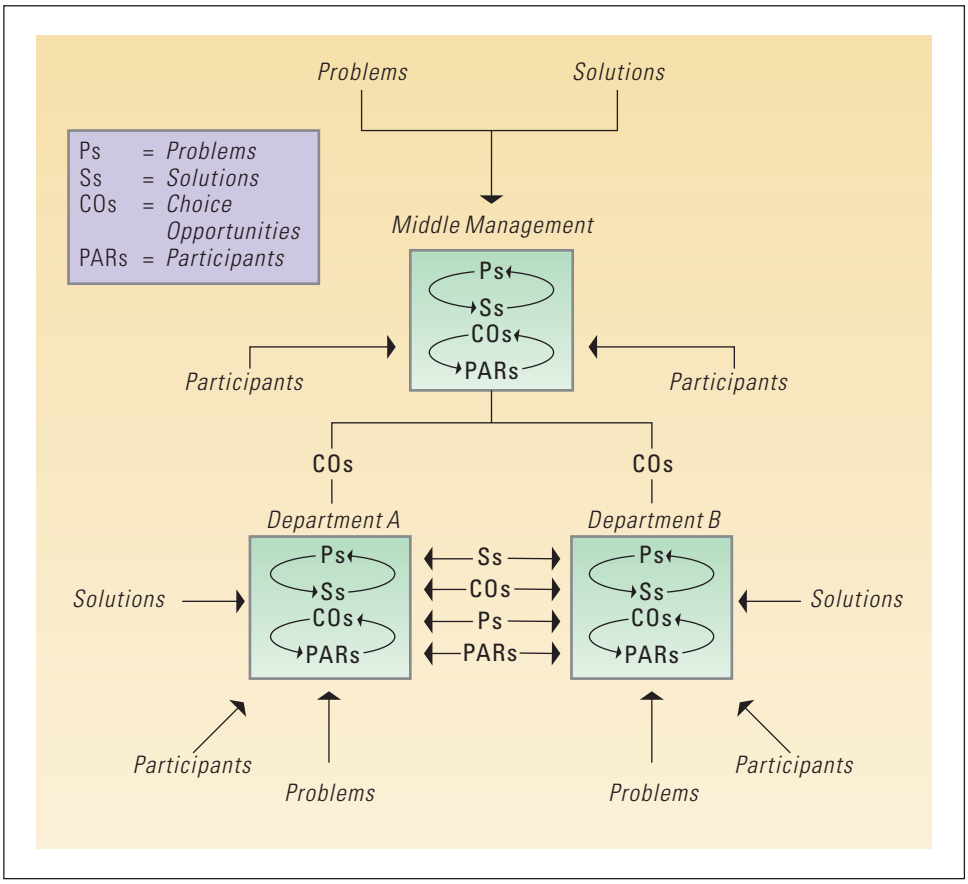

EXHIBIT 13.8
Illustration of Independent Streams of Events in the Garbage Can Model of Decision Making

Thus, when viewing the organization as a whole and considering its high level of uncertainty, one sees problems arise that are not solved and solutions tried that do not work. Organizational decisions are disorderly and not the result of a logical, step-by-step sequence. Events may be so ill-defined and complex that decisions, problems, and solutions act as independent events. When they connect, some problems are solved, but many are not.[91]

Consequences. There are four specific consequences of the garbage can decision process for organizational decision making:

1. *Solutions may be proposed even when problems do not exist.* An employee might be sold on an idea and might try to sell it to the rest of the organization. An example was the adoption of computers by many organizations during the 1970s. The computer was an exciting solution and was pushed by both computer manufacturers and systems analysts within organizations. The computer did not solve any problems in those initial applications. Indeed, some computers caused more problems than they solved.
2. *Choices are made without solving problems.* A choice—for example, creating a new department or revising work procedures—may be made with the intention of solving a problem; but, under conditions of high uncertainty, the choice may be incorrect. Moreover, many choices just seem to happen. People decide to quit, the organization's budget is cut, or a new policy bulletin is issued. These choices may be oriented toward problems but do not necessarily solve them.

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3. *Problems may persist without being solved.* Organization participants get used to certain problems and give up trying to solve them; or participants may not know how to solve certain problems because the technology is unclear. A university in Canada was placed on probation by the American Association of University Professors because a professor had been denied tenure without due process. The probation was a nagging annoyance that the administrators wanted to remove. Fifteen years later, the nontenured professor died. The probation continues because the university did not acquiesce to the demands of the heirs to re-evaluate the case. The university would like to solve the problem, but administrators are not sure how, and they do not have the resources to allocate to it. The probation problem persists without a solution.
4. *A few problems are solved.* The decision process does work in the aggregate. In computer simulations of the garbage can model, important problems were often resolved. Solutions do connect with appropriate problems and participants so that a good choice is made. More recently, some researchers have set up laboratory experiments to see if real humans do what the computer simulations predict. They have found that real humans and computer simulations produce almost identical results in terms of some aspects, such as number of choices made and number of problems solved.[92] Of course, not all problems are resolved when choices are made, but the organization does move in the direction of problem reduction.

The effects of independent streams and the rather chaotic decision processes of the garbage can model can be seen in the following example from Volkswagen. Problems, ideas, opportunities, and people seem to appear and combine haphazardly to produce decision outcomes.

IN PRACTICE
Volkswagen

PA Images/Alamy Stock Photo

Graduate students from West Virginia University (participants) tested the exhaust from a VW Jetta and found strange behavior by the Volkswagen diesel (problem). The students and their professors wrote a report exposing the problem. Volkswagen's head of safety (participant) examined the study and responded with a one-page report about the West Virginia findings: the Jetta had emitted 15 to 35 times the permitted amounts of nitrogen oxides (problem). However, the same cars were able to pass tests conducted in a laboratory. The head of safety concluded (choice opportunity) that a thorough explanation could not be given to the authorities.

Volkswagen managers (participants) considered various options (choice opportunities): (a) refuse to acknowledge a problem, (b) offer to update the engine software, (c) admit there was a problem and buy back diesel cars sold in the United States.

Alberto Ayala (participant) of the California Air Resources Board (CARB) decided (choice opportunity) to initiate a stronger inquiry. A process unfolded wherein engineers from CARB (participants) would run tests and meet with Volkswagen engineers (participants) to compare notes. This back-and-forth dragged on without a solution. Volkswagen would complain that CARB's testing was wrong. At a subsequent meeting, VW representatives (participants)

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suggested a diesel recall to update the engine software (choice opportunity, solution). However, this turned out to be a delaying tactic by VW (problem). Volkswagen updated the software in 280,000 vehicles so the cars polluted less than previously (solution), but the illegal software code had not been removed (choice, solution for VW).

CARB tests found that the recall and software update had not solved the problem of excess pollution (problem). CARB insisted that VW reveal the software code that governed the emissions control system (choice). A Volkswagen committee (participants) discussed the crisis and decided (choice) to create a task force to confront the issue with a more assertive position (choice). VW then provided another thick binder of technical information supposedly to prove a better result (solution), which CARB engineers determined was total nonsense. The only conclusion (decision) was that VW had used some kind of illegal software to defeat emissions testing.

CARB put added pressure on Volkswagen, and Volkswagen executives realized they had run out of excuses (choice opportunity). In the next meeting with CARB, the VW representative (participant) admitted (choice) that the VW cars contained a defeat device. On September 3, 2015, Volkswagen formally admitted to regulators (choice) that 500,000 diesel vehicles sold in the United States had two calibrations—one for emissions testing and one for normal road operation. The research by West Virginia University graduate students eventually cost Volkswagen more than $22 billion in fines and legal settlements (solution).[93]

The story of Volkswagen's challenges illustrates the garbage can model of decision making and the diverse and sometimes unexpected flow of people, problems, potential solutions, and choice opportunities through an organization. Problems are not solved in a simple, logical, step-by-step sequence. Some problems were thought to have been solved at Volkswagen, or at least reduced, but many persisted despite the proposed solutions and decision choices that were made. Some events occurred by chance, such as the West Virginia University emissions testing. VW managers tried various solutions to its emissions problems, and some might have worked. Others persisted for a year or more. New choices will always be made and other choice opportunities embraced or rejected as people with various ideas come and go and outside forces continue to change.

REMEMBER THIS

- To cope with extreme uncertainty and complexity, managers combine the Carnegie and incremental decision-making models and may also use a unique approach called the garbage can model.
- The garbage can model describes how decision processes can seem almost random in highly organic organizations.
- Many organizations occasionally find themselves in positions of making decisions under unclear, problematic circumstances and the garbage can model is useful for understanding the pattern of these decisions.
- Decisions, problems, ideas, and people flow through organizations and mix together in various combinations. Through this process, the organization gradually learns. Some problems may never be solved, but many are, and the organization will move toward maintaining and improving its level of performance.

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13.6 Contingency Decision-Making Framework

This chapter has covered several approaches to organizational decision making, including management science, the Carnegie model, the incremental decision model, and the garbage can model. It has also discussed rational and intuitive decision processes used by individual managers and looked at cognitive biases and other constraints that impinge on decision making. Each decision approach is a relatively accurate description of the actual decision process, yet all differ from each other. Management science, for example, reflects a different set of decision assumptions and procedures than does the garbage can model.

One reason for having different approaches is that they appear in different organizational situations. The use of an approach is contingent on the organization setting. Two characteristics of organizations that determine the use of decision approaches are (1) problem consensus and (2) technical knowledge about the means to solve those problems.[94] Analyzing organizations along these two dimensions suggests which approach is most appropriate for making decisions.

13.6a Problem Consensus

Problem consensus refers to the agreement among managers about the nature of a problem or opportunity and about which goals and outcomes to pursue. This variable ranges from complete agreement to complete disagreement. When managers agree, there is little uncertainty—the problems and goals of the organization are clear and so are standards of performance. When managers disagree, organization direction and performance expectations are in dispute, creating a situation of high uncertainty. One example of problem uncertainty occurred at Rockford Health System. Human resource managers wanted to implement a new self-service benefits system, which would allow employees to manage their own benefits and free up HR employees for more strategic activities. Finance managers, on the other hand, argued that the cost of the software licenses was too high and would hurt the company's bottom line. Managers in other departments also disagreed with the new system because they feared adoption of an expensive new HR system meant they might not get their departmental projects approved.[95]

Problem consensus tends to be low when organizations are differentiated, as described in Chapter 4. Recall that uncertain environments cause organizational departments to differentiate from one another in goals and attitudes to specialize in specific environmental sectors. This differentiation leads to disagreement and conflict, so managers must make a special effort to build coalitions during decision making. For example, NASA was severely criticized for failing to identify problems with the *Columbia* space shuttle that might have prevented the February 2003 disaster. A part of the reason was high differentiation and conflicting opinions between safety managers and scheduling managers, in which pressure to launch on time overrode safety concerns. In addition, after the launch, engineers three times requested—and were denied—better photos to assess the damage from a piece of foam debris that struck the shuttle's left wing just seconds after launch. Investigations later indicated that the damage caused by the debris may have been the primary physical cause of the explosion. Mechanisms for hearing dissenting opinions and building coalitions can improve decision making at NASA and other organizations dealing with complex problems.[96]

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Problem consensus is especially important for the problem identification stage of decision making. When problems are clear and agreed on, they provide clear standards and expectations for performance. When problems are not agreed on, problem identification is uncertain and management attention must be focused on gaining agreement about goals and priorities.

13.6b Technical Knowledge about Solutions

Technical knowledge refers to understanding and agreement about how to solve problems and reach organizational goals. This variable can range from complete agreement and certainty to complete disagreement and uncertainty about cause–effect relationships leading to problem solution. One example of low technical knowledge occurred at Dr. Pepper/Seven-Up Inc. Managers agreed on the problem to be solved—they wanted to increase market share from six to seven percent. However, the means for achieving this increase in market share were not known or agreed on. A few managers wanted to use discount pricing in supermarkets. Other managers believed they should increase the number of soda fountain outlets in restaurants and fast-food chains. A few other managers insisted that the best approach was to increase advertising. Managers did not know what would cause an increase in market share. Eventually, the advertising judgment prevailed, but it did not work very well. The failure of the decision reflected managers' low technical knowledge about how to solve the problem.

When means are well understood, the appropriate alternatives can be identified and calculated with some degree of certainty. When means are poorly understood, potential solutions are ill-defined and uncertain. Intuition, judgment, and trial and error become the basis for decisions.

13.6c Contingency Framework

Exhibit 13.9 describes the **contingency decision-making framework**, which brings together the two dimensions of problem consensus and technical knowledge about solutions. Each cell represents an organizational situation that is appropriate for the decision-making approaches described in this chapter.

Cell 1. In cell 1 of Exhibit 13.9, rational decision procedures are used because problems are agreed on and cause–effect relationships are well understood, so there is little uncertainty. Decisions can be made in a computational manner. Alternatives can be identified and the best solution adopted through analysis and calculations. The rational models described earlier in this chapter, both for individuals and for the organization, are appropriate when problems and the means for solving them are well defined.

Cell 2. In cell 2, there is high uncertainty about problems and priorities, so bargaining and compromise are used to reach consensus. Tackling one problem might mean the organization must postpone action on other issues. The priorities given to respective problems are decided through discussion, debate, and coalition building.

Managers in this situation should use broad participation to achieve consensus in the decision process. Opinions should be surfaced and discussed until compromise is reached. The organization will not otherwise move forward as an integrated

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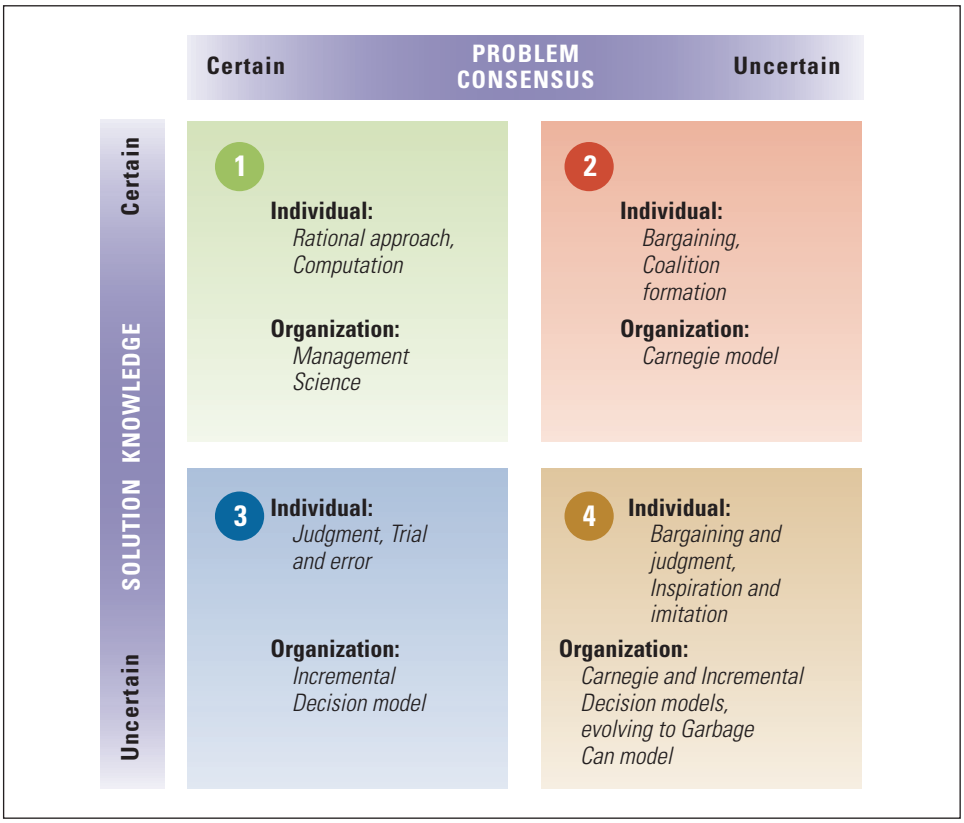
EXHIBIT 13.9
Contingency Framework for Using Decision Models



unit. The Carnegie model applies when there is dissension about organizational problems. When groups within the organization disagree or when the organization is in conflict with constituencies (government regulators, suppliers, unions), bargaining and negotiation are required. The bargaining strategy is especially relevant to the problem identification stage of the decision process. Once bargaining and negotiation are completed, the organization will have support for one direction.

Cell 3. In a cell 3 situation, problems and standards of performance are certain, but alternative technical solutions are vague and uncertain. Techniques to solve a problem are ill-defined and poorly understood. When an individual manager faces this situation, intuition will be the decision guideline. The manager will rely on past experience and judgment to make a decision. Rational, analytical approaches are not effective because the alternatives cannot be identified and calculated. Hard facts and accurate information are not available.

The incremental decision model reflects trial and error on the part of the organization. Once a problem is identified, a sequence of small steps enables the organization to learn a solution. As new problems arise, the organization may recycle back to an earlier point and start over. Eventually, over a period of months or years, the organization will acquire sufficient experience to solve the problem in a satisfactory way.

The situation in cell 3, of senior managers agreeing about problems but not knowing how to solve them, occurs frequently in business organizations. If managers use incremental decisions in such situations, they will eventually acquire the technical knowledge to accomplish goals and solve problems.

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Cell 4. The situation in cell 4, characterized by high uncertainty about both problems and solutions, is difficult for decision making. An individual manager making a decision under this high level of uncertainty can employ techniques from both cells 2 and 3. The manager can attempt to build a coalition to establish goals and priorities and use judgment, intuition, or trial and error to solve problems. Additional techniques, such as inspiration and imitation, also may be required. **Inspiration** refers to an innovative, creative solution that is not reached by logical means. Inspiration sometimes comes like a flash of insight, but—similar to intuition—it is often based on deep knowledge and understanding of a problem that the unconscious mind has had time to mull over.[97] **Imitation** means adopting a decision tried elsewhere in the hope that it will work in this situation.

An example from a university accounting department provides an illustration. Faculty members were unhappy with their current circumstances but could not decide on the direction the department should take. Some faculty members wanted a greater research orientation, whereas others wanted greater orientation toward business firms and accounting applications. The disagreement about goals was compounded because neither group was sure about the best technique for achieving its goals. The ultimate solution was inspirational on the part of the dean. An accounting research center was established with funding from major accounting firms. The funding was used to finance research activities for faculty interested in basic research and to provide contact with business firms for other faculty. The solution provided a common goal and unified people within the department to work toward that goal.

When an entire organization is characterized by high uncertainty regarding both problems and solutions, elements of the garbage can model will appear. Managers may first try techniques from both cells 2 and 3, but logical decision sequences starting with problem identification and ending with problem solution will not occur. Potential solutions will precede problems as often as problems precede solutions. In this situation, managers should encourage widespread discussion of problems and idea proposals to facilitate the opportunity to make choices. Eventually, through trial and error, the organization will solve some problems.

Research has found that decisions made following the prescriptions of the contingency decision-making framework tend to be more successful. However, the study noted that nearly six of 10 strategic management decisions failed to follow the framework, leading to a situation in which misleading or missing information decreased the chance of an effective decision choice.[98] Managers can use the contingency framework in Exhibit 13.9 to improve the likelihood of successful organizational decisions.

REMEMBER THIS

- Different decision-making approaches are appropriate for different situations. Two characteristics that should be considered are problem consensus and technical knowledge about solutions.
- Problem consensus is especially important for the problem identification stage of decision making. When problems are not agreed on, problem identification is uncertain and management attention must be focused on gaining agreement about goals and priorities.
- Technical knowledge refers to the level of understanding and concurrence about how to solve the identified and agreed upon problems to reach organizational goals.
- Managers can follow the prescriptions of the contingency decision-making framework to use the correct decision-making approach and increase the likelihood of a successful decision.

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13.7 Special Decision Circumstances

In a highly competitive world beset by global competition and rapid change, decision making seldom fits the traditional rational, analytical model. Today's managers have to make high-stakes decisions more often and more quickly than ever before in an environment that is increasingly less predictable. Interviews with CEOs in high-tech industries, for example, found that they strive to use some type of rational process, but the uncertainty and change in the industry often make that approach unsuccessful. The way these managers actually reach decisions is through a complex interaction with other managers, subordinates, environmental factors, and organizational events.[99] Issues of particular concern for today's decision makers are coping with high-velocity environments and learning from decision mistakes.

13.7a High-Velocity Environments

In some industries, the rate of competitive and technological change is so extreme that market data are either unavailable or obsolete, strategic windows open and shut quickly, perhaps within a few months, and the cost of poor decisions may be company failure. Research has examined how successful companies make decisions in these **high-velocity environments**, especially to understand whether organizations abandon rational approaches or have time for incremental implementation.[100]

A comparison of successful with unsuccessful decisions in high-velocity environments found the following patterns:

- Successful decision makers tracked information in real time to develop a deep and intuitive grasp of the business. Two to three intense meetings per week with all key players were usual. Decision makers closely tracked operating statistics to constantly feel the pulse of what was happening. Unsuccessful firms were more concerned with future planning and forward-looking information, with only a loose grip on immediate happenings.
- During a major decision, successful companies began immediately to build multiple alternatives. Implementation of alternatives sometimes ran in parallel before managers settled on a final choice. Companies that made decisions slowly developed just one alternative, moving to another only after the first one failed.
- Fast, successful decision makers sought advice from everyone and depended heavily on one or two savvy, trusted colleagues as counselors. Slow companies were unable to build trust and agreement among the best people.
- Fast companies involved everyone in the decision and tried for consensus; but if consensus did not emerge, the top manager made the choice and moved ahead. Waiting for everyone to be on board created more delays than was warranted. Slow companies delayed decisions to achieve a uniform consensus.
- Fast, successful choices were well integrated with other decisions and the overall strategic direction of the company. Less successful choices considered the decision in isolation from other decisions; the decision was made in the abstract.[101]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Track real-time information, build multiple alternatives simultaneously, and try to involve everyone—but move ahead anyway when making decisions in a high-velocity environment.

When speed matters, a slow decision can be as ineffective as the wrong decision. Managers can learn to make decisions quickly. To improve the chances of a good decision under high-velocity conditions, some organizations stimulate constructive conflict through a technique called **point–counterpoint**, which divides decision makers into two groups and assigns them different, often competing responsibilities.[102] The groups develop and exchange proposals and debate options until they arrive

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at a common set of understandings and recommendations. Groups can often make better decisions because multiple and diverse opinions are considered. In the face of complexity and uncertainty, the more people who have a say in the decision making, the better.

In group decision making, a consensus may not always be reached, but the exercise gives everyone a chance to consider options and state their opinions, and it gives top managers a broader understanding. Typically, those involved support the final choice. However, if a very speedy decision is required, top managers are willing to make the decision and move forward.

13.7b Decision Mistakes and Learning

Organizational decisions result in many errors, especially when made in conditions of great uncertainty. Managers simply cannot determine or predict which alternative will solve a problem. In these cases, managers must make the decision—and take the risk—often in the spirit of trial and error. If an alternative fails, they can learn from it and try another alternative that better fits the situation. Each failure provides new information and insight. The point for managers is to move ahead with the decision process despite the potential for mistakes. "Chaotic action is preferable to orderly inaction."[103]

In some organizations, managers are encouraged to instill a climate of experimentation to facilitate creative decision making. If one idea fails, another idea should be tried. Failure often lays the groundwork for success, such as when technicians at 3M developed Post-it Notes based on a failed product—a not-very-sticky glue. Managers in the most innovative companies believe that if all their new products succeed, they're doing something wrong, not taking the necessary risks to develop new markets. In other words, they recognize that when failure teaches the company something new, it lays the groundwork for success. James Quincey, the new CEO of the Coca-Cola Company, is pushing the company to ditch its culture of cautiousness, nicknamed "The New Coke Syndrome" after the company's disastrous 1985 decision to reformulate Coke, and take more risks, even if it leads to failures. "If we're not making mistakes, we're not trying hard enough," Quincey said. "We've got to try things. Not all of them will work. We don't need to get too upset when we have failures. We need to learn, move on, and reinvent."[104]

Only by making mistakes can managers and organizations go through the process of **decision learning** and acquire sufficient experience and knowledge to perform more effectively in future decisions. Some companies even give awards for failures that lead to learning. Grey Advertising awards an annual "Heroic Failure" trophy, to reward the "glorious defeats that can make success itself look timid."[105] At Intuit, one winner of the failure award was the team that developed an aggressive marketing campaign to target young tax filers. Through a website called RockYourRefund.com, Intuit offered discounts to Best Buy and other companies and the ability to deposit tax refunds directly into prepaid Visa cards issued by hip-hop star and entrepreneur Russell Simmons. The campaign was a bust, with Intuit doing "very few returns" through the site. A postmortem of the project gave the team lessons they applied to future projects, such as the fact that young people shun websites that feel too much like advertising. "It's only a failure if we fail to get the learning," said former Intuit chairman Scott Cook.[106]

Based on what has been said about decision making in this chapter, one can expect companies to be ultimately successful in their decision making by adopting a learning approach toward solutions. They will make mistakes along the way, but they will resolve uncertainty through the trial-and-error process.

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ASSESS YOUR ANSWER

3 Making a poor decision can help a manager and organization learn and get stronger.

ANSWER: *Agree.* Managers don't want people to intentionally make poor decisions, of course, but smart managers encourage people to take risks and experiment, which can lead to failed decisions. Learning from the failures is the key to growing and improving. In addition, although managers strive to make good decisions, they understand that decisions sometimes must be made quickly based on limited information and that trial and error is an important way the organization learns and grows stronger.

REMEMBER THIS

- Many organizations operating in high-velocity environments must make decisions with speed, which means staying in immediate touch with operations and the environment.
- Moreover, in an uncertain world, organizations will make mistakes, and mistakes made through trial and error should be appreciated. Encouraging trial-and-error increments facilitates organizational learning.

KEY CONCEPTS

bounded rationality perspective
Carnegie model
coalition
cognitive biases
contingency decision-making framework
decision learning
devil's advocate
escalating commitment
evidence-based management
garbage can model
groupthink
high-velocity environments
imitation
incremental decision model
inspiration
intuitive decision making
management science approach
nonprogrammed decisions
organizational decision making
organized anarchy
point–counterpoint
problem consensus
problem identification
problem solution
problemistic search
programmed decisions
prospect theory
quasirationality
rational approach
satisficing
technical knowledge

ANSWERS TO QUESTIONS IN EXHIBIT 13.4

1. The answer is unbelievably huge: roughly 800,000,000,000,000 times the distance between the Earth and the sun. Your mind was *anchored* in the thinness of a sheet of paper, thereby leading you to dramatically underestimate the effect of doubling the thickness 100 times. Initial mental anchoring to a low or high point leads to frequent incorrect solutions. How certain did you feel about your answer? This is an example of *overconfidence*, a major cause of manager mistakes. This decision also illustrates *bounded rationality* because your mind could not process the true complexity of the problem.

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2. The answer is six hours. The 25 butts will make five cigarettes that will last five hours. The butts from those five cigarettes will make one additional cigarette to last the sixth hour. If you don't focus carefully on the problem and possible solutions, you may overlook important information.
3. Every figure is different in some way. Figure (a) has the greatest area, (b) has the least area, (c) is the only square, (d) is the only three-sided figure, (e) is most narrow and lopsided, and (f) is least symmetrical and five-sided. Did you stop after finding one correct answer? This would have prevented you from finding the ultimate correct answer.
4. If you checked "yes," you felt the desire to continue investing in a previous decision even when it was failing, which is called *escalating commitment*. This is the mistake many managers make because they are emotionally attached to the previous decision, even one as hopeless as this inadequate drone.
5. The median estimate from students is 2,250. When the numbers are given in reverse order starting with 1 x 2, etc., the median estimate is 512. The correct answer is 40,320. The order in which information is presented makes a difference to a person's solution, and acting quickly produces an answer that is far from correct.
6. The correct answer is 11. Many people answer 7. Native English speakers pronounce the word *of* with a "v" sound, hence the f does not register in their minds. A manager's conditioning can blind him or her to important information for solving a problem.
7. When judging people, early information has more impact than later information, called the *primacy effect*. Reversing the word sequence so that "intelligent" and "industrious" come first creates a more favorable impression. Respondents rate Robert more or less emotional depending on the order of the descriptive words.
8. Although the options are numerically equivalent, most people choose alternatives B and C. People hate losing more than they enjoy winning, which is referred to as *loss aversion*. Hence, about 80 percent of people choose a sure small gain (B), and 70 percent will take more risk in the hope of avoiding a loss (C). A manager's solutions may be asymmetrical when they involve financial gains and losses.

DISCUSSION QUESTIONS

1. When you are faced with choosing between several valid options, how do you typically make your decision? How do you think managers typically choose between several options? What are the similarities between your decision process and what you think managers do?
2. A professional economist once told his class, "An individual decision maker should process all relevant information and select the economically rational alternative." Do you agree? Why or why not?
3. If managers frequently use experience and intuition to make complex, nonprogrammed decisions, how do they apply evidence-based management, which seems to suggest that managers should rely on facts and data?
4. The Carnegie model emphasizes the need for a political coalition in the decision-making process. When and why are coalitions necessary?
5. What are the three major phases in Mintzberg's incremental decision model? Why might an organization recycle through one or more phases of the model?
6. An organization theorist once told her class, "Organizations never make big decisions. They make small decisions that eventually add up to a big decision." Explain the logic behind this statement.
7. How would you make a decision to select a building site for a new waste-treatment plant in the Philippines? Where would you start with this complex decision, and what steps would you take? Explain which decision model in the chapter best describes your approach.
8. Why would managers in high-velocity environments worry more about the present than the future? Would an individual manager working in this type of environment be more likely to succeed with a rational approach or an intuitive approach? Discuss.
9. Can you think of a decision you have made in your personal, school, or work life that reflects a stronger desire to avoid a loss than to make a gain? How about a time when you stayed with an idea or project for too long, perhaps even escalating your commitment, to avoid a failure? Discuss.
10. Why do you think decision mistakes are usually accepted in organizations but penalized in college courses and exams that are designed to train managers?

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CHAPTER 13 WORKSHOP Style of Decision Making

Respond to each of the following statements based on how you have *actually* approached a difficult problem at school or work. Indicate whether each statement is True, Somewhat True, or False for you.

	True	Somewhat	False
1. I tried to see the problem in its entirety and see how it affected other people or departments.	_____	_____	_____
2. I started by integrating information from different areas.	_____	_____	_____
3. I enjoyed solving a complex rather than a simple problem.	_____	_____	_____
4. I systematically talked to people who had diverse perspectives on the problem.	_____	_____	_____
5. I certainly attempted to link a solution to an overall strategy or plan.	_____	_____	_____
6. I analyzed root causes of the problem to find leverage points for a solution.	_____	_____	_____
7. My approach was to focus on one part of the problem at a time.	_____	_____	_____
8. I took time to consider the situation from all angles.	_____	_____	_____
9. I studied how different parts of the relevant organization interacted to affect the problem.	_____	_____	_____

Scoring and Interpretation:

Sum questions 1-9 by giving yourself 3 points for each True, 2 points for each Somewhat, and 1 point for each False, except for question 6, which should be reverse scored (3 points for False and 1 point for True). **Total Score: _____.**

Systemic thinking during the decision process means that the decision maker uses a holistic rather than reductionist perspective to view the problem and gather information. A score high on systemic thinking means a focus on the big picture and how the parts fit together. A score low on systemic thinking means analytic thinking, which breaks things down into specific parts of an overall problem. Analytic thinkers focus on specific parts of a problem and may probe into underlying causes, while systemic thinkers strive to understand how and why the parts fit together into a larger context. Analytic thinkers do well with solving technical problems while systemic thinkers may thrive on problems that affect multiple parts of an organization.

The mean score of 30 students was 21.6. Generally speaking, a score of 22 or higher suggests a systemic thinking style and a score of 20 or lower suggests an analytic style.

Questions

Form into small groups of 3–4 students and compare scores. Then answer the following questions:

1. Do the scores make intuitive sense to each group member with respect to making decisions, as you know yourselves and each other?
2. Does your thinking style reflect your career interest, such as strategic management (systemic) vs. accounting or finance (analytic)?
3. Share your group's range of scores and interpretations with the rest of the class to learn the pattern of scores and interpretations across groups.

CASE FOR ANALYSIS | Government DTS[107]

Harmon Davidson stared dejectedly at the departing figure of his management survey team leader. Their meeting had not gone well. Davidson had relayed to Al Pitcher complaints about his handling of the survey. Pitcher had responded with adamant denial and unveiled scorn.

Davidson, director of headquarters management, was prepared to discount some of the criticism as resentment of outsiders meddling with "the way we've always done business," exacerbated by the turbulence of continual reorganization. But Davidson could hardly ignore the sheer volume of complaints or his high regard for some of their sources. "Was I missing danger signals about Pitcher from the start?" Davidson asked himself. "Or was I just giving a guy I didn't know a fair chance with an inherently controversial assignment?"

With his division decimated in the latest round of downsizing at the Department of Technical Services (DTS) earlier that year, Davidson had been asked to return to the headquarters management office after a five-year hiatus. The director, Walton Drummond, had abruptly taken early retirement.

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One of the first things Davidson had learned about his new job was that he would be responsible for a comprehensive six-month survey of the headquarters management structure and processes. The DTS secretary had promised the survey to the White House as a prelude to the agency's next phase of management reform. Drummond had already picked the five-person survey team consisting of two experienced management analysts, a promising younger staff member, an intern, and Pitcher, the team leader. Pitcher was fresh from the Treasury Department, where he had participated in a similar survey. But having gone off after retirement for an extended mountain-climbing expedition in Asia, Drummond was unavailable to explain his survey plans or any understandings he had reached with Pitcher.

Davidson had been impressed with Pitcher's energy and motivation. He worked long hours, wrote voluminously if awkwardly, and was brimming with the latest organizational theory. Pitcher had other characteristics, however, that were disquieting. He seemed uninterested in DTS's history and culture and was paternalistic toward top managers, assuming they were unsophisticated and unconcerned about modern management.

A series of pre-survey informational briefings for headquarters office heads conducted by Davidson and Pitcher seemed to go swimmingly. Pitcher deferred to his chief on matters of philosophy and confined his remarks to schedule and procedures. He closed his segment on a friendly note, saying, "If we do find opportunities for improvement, we'll try to have recommendations for you."

But the survey was barely a week old when the director of management received his first call from an outraged customer. It was the assistant secretary for public affairs, Erin Dove, and she was not speaking in her usual upbeat tones. "Your folks have managed to upset my whole supervisory staff with their comments about how we'll have to change our organization and methods," she said. "I thought you were going through a fact-finding study. This guy Pitcher sounds like he wants to remake DTS headquarters overnight. Who does he think he is?"

When Davidson asked him about the encounter with public affairs, Pitcher expressed puzzlement that a few summary observations shared with supervisors in the interest of "prompt informal feedback" had been interpreted as such disturbing conclusions. "I told them we'll tell them how to fix it," he reassured his supervisor.

"Listen, Al," Davidson remonstrated gently. "These are very accomplished managers who aren't used to being told they have to fix anything. This agency's been on a roll for years, and the need for reinvention isn't resonating all that well yet. We've got to collect and analyze the information and assemble a convincing case for change, or we'll be spinning our wheels. Let's hold off on the feedback until you and I have reviewed it together."

But two weeks later, Technology Development Director Phil Canseco, an old and treasured colleague, was on Davidson's doorstep looking as unhappy as Erin Dove had sounded on the phone. "Harmon, buddy, I think you have to rein in this survey team a bit," he said. "Several managers who were scheduled for survey interviews were working on a 24-hour turnaround to give a revised project budget to the Appropriations subcommittee that day. My deputy says Pitcher was put out about postponing interviews and grumbled about whether we understood the new priorities. Is he living in the real world?"

Canseco's comments prompted Davidson to call a few of his respected peers who had dealt with the survey team. With varying degrees of reluctance, they all criticized the team leader and, in some cases, team members, as abrasive and uninterested in the rationales offered for existing structure and processes.

And so, Davidson marshaled all of his tact for a review with the survey team leader. But Pitcher was in no mood for either introspection or reconsideration. He took the view that he had been brought in to spearhead a White House-inspired management improvement initiative in a glamour agency that had never had to think much about efficiency. He reminded Davidson that even he had conceded that managers were due some hard lessons on this score. Pitcher didn't see any way to meet his deadline except by adhering to a rigorous schedule, since he was working with managers disinclined to cooperate with an outsider pushing an unpopular exercise. He felt Davidson's role was to hold the line against unwarranted criticisms from prima donnas trying to discredit the survey.

Many questions arose in Davidson's mind about the survey plan and his division's capacity to carry it out. Had they taken on too much with too little? Had the right people been picked for the survey team? Had managers and executives, and even the team, been properly prepared for the survey?

But the most immediate question was whether Al Pitcher could help him with these problems.

Questions

1. What type of decision process does Pitcher seem to be using in his work with other departments? What type of process should he be using in this situation? Explain.
2. How would Davidson apply the Carnegie model to make a decision about Pitcher at this point? Explain.
3. Does the type of decision process Pitcher appears to use when working with other departments reflect any personal constraints (Exhibit 13.3)? Any cognitive biases? Explain.

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CASE FOR ANALYSIS | Dubois French Eatery

Hu-go. Hu-go.

As Alissa Mason drove up the mountain through the rain, she turned up the volume on the radio to clear her mind. However, even the steady rhythm of the truck's windshield wipers steered her mind back to *the problem*—Hu-go, Hu-go. Ten years earlier, Alissa's dream of opening a French-style restaurant came true with the launching of *Dubois*. Even now, Alissa smiled, recalling how the once-annoying habit of mispronunciation (Doo-boys instead of Doob-WAH) by ranchers and townspeople had become yet another endearing quality of owning a business in a small town.

In 2000, a graduation gift from her rancher dad provided Alissa the opportunity to travel throughout France, culminating in a stint at a cooking school in Paris. Upon return to her hometown, and armed with a dream, her MBA, and a box load of ideas for tantalizing meals, Alissa was certain she had the recipe for success. She was right.

The opening of Dubois French Eatery in her hometown was a triumph and its popularity and reputation for delicious food spread rapidly, attracting state and regional press coverage. In addition to a strong local customer base, the restaurant's location on the route from the interstate to several popular mountain resorts offered opportunities to become a favorite stopover for tourists, skiers, and hikers. Within a few years, the amazing success of the business and the constant barrage of suggestions for a second location closer to the resorts encouraged Alissa to consider expansion. The problem would be how she would manage locations almost an hour apart while maintaining the level of quality and service customers expected.

Hugo Marchand appeared to be the answer to her prayers. A handsome, charming Frenchman, Hugo was a talented chef from a large family of talented chefs. The youngest of four brothers, Hugo realized he would not inherit the family restaurant and decided to emigrate to America to build a reputation as a chef away from his dominating father and brothers.

Hugo's experience and amazing talents as a chef, his natural ease in managing staff, and the charm and joy he displayed in his interaction with customers soon convinced Alissa that she had found the perfect person to direct the new restaurant. Looking back, she realized her own enthusiasm for expansion and a starry-eyed impression of the Frenchman, shared by an adoring public, led to mistakes in her business judgment.

Following a fabulous opening, the new restaurant soared to financial success, far outpacing its small-town sister location. But by the end of the second year, problems loomed. Alissa's travels to the resort location became more frequent, cutting into the time needed at the original restaurant. Crowds filled the resort location. ("We love Hugo." "You're so lucky to have found him.") Patrons waited patiently in line. However, delivery problems led to frequent changes in popular menu items. Recurring delinquency in the payment of bills and invoices, as well as Hugo's increasingly lax attitude regarding his presence on site, led to confrontations. Realizing his value to the organization, Alissa always accepted Hugo's promises to do better. Each time, the problems returned, and staff frustration at both locations increased.

Recently, rumors reached Alissa that Hugo was exploring the possibility of opening his own rival French restaurant. Alissa was not sure she wanted to keep Hugo, but she did not want her popular chef to move and take devoted customers with him. The bottom line—the clientele wanted Hugo. Alissa was certain he would be able to obtain financial backing for his venture based upon his talents and popularity. She realized she must do something before Hugo moved further into the process.

As she drove, Alissa was aware of the increasing stress. The situation with Hugo was taking over every aspect of her life. The time for serious discussion loomed. For days she had weighed her options.

Status Quo

Alissa liked Hugo and would like to avoid another confrontation. Her own management style was nonconfrontational and she wondered if sitting down with Hugo to discuss a more manageable plan for handling office management details at his location would be a good solution until she could be certain of his future plans. The thought of hiring someone to assist Hugo with the business details occurred to her, but that meant the addition of another full-time employee—a step she was not sure she could take at this time.

Discipline or Fire Hugo

With a repeat of the same problems that had been addressed on previous occasions, Alissa felt that disciplinary steps were futile. However, firing Hugo set up the very situation—her talented chef as a rival—that she wanted to avoid. Still, with his shaky business skills, there was no guarantee he would be able to create a strong business plan, secure financial backing, and sustain a rival restaurant, despite his popularity and talents as a chef. It would not be the first time a great chef failed as an owner.

Focus on Dubois II

Alissa wondered if it would be better to move the entire operation to the resort. The original restaurant had her

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heart, but the resort location had the talented chef and the bulk of the clientele. If she closed the first location and maintained only the resort location, she would take over the business side, relieve Hugo of the responsibility for which he was obviously ill-suited, and maintain more control over his work habits.

Offer Hugo a Partnership

Rewarding Hugo with a partnership might be a way to keep him and impose a stronger sense of loyalty as well as pride in building a greater sense of urgency for his reputation and success as a businessman. However, if she offered Hugo a minority stake, she would give up a portion of control and increase his role in the direction and day-to-day operations of the business.

Decision Time

As Alissa pulled into the parking lot, the rain ended and Hugo stepped out of the doorway and waved. With no clear answer, she walked with Hugo to his office.

Questions

1. The initial problem for Alissa was how she would manage locations one hour apart and maintain high quality and service. The current problem is Hugo's management style. To what extent would you say these two problems are programmed vs. non-programmed? Explain.
2. What type of decision process led Alissa to hire Hugo (e.g., rational, intuitive, satisficing, non-programmed, bounded rationality, Carnegie Model, etc.)? What type of decision process should Alissa have used? Why?
3. By the end of the second year, problems loomed. Patrons loved Hugo, but there were delivery problems, bill-paying delinquency, lax business attitude, and the possibility of Hugo opening a competing restaurant. If you were a consultant, what you advise Alissa to do? Why?

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CHAPTER

14 Conflict, Power, and Politics

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Learning Objectives

After reading this chapter you should be able to:

1. Identify organizational characteristics that can cause intergroup conflict.
2. Compare and contrast the rational and the political models of organization.
3. Describe the vertical sources of power in organizations.
4. Explain the concept of strategic contingencies as it relates to horizontal power in organizations.
5. Define politics and explain why political activity is necessary.
6. Identify tactics for increasing and for using power.

Chapter Outline

Interdepartmental Conflict in Organizations

Sources of Conflict • Rational Versus Political Model • Tactics for Enhancing Collaboration

Power and Organizations

Individual Versus Organizational Power • Power Versus Authority • Vertical Sources of Power • The Power of Empowerment • Horizontal Sources of Power

Political Processes in Organizations

Definition • When to Use Political Activity

Using Soft Power and Politics

Tactics for Increasing Power • Political Tactics for Using Power

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Before reading this chapter, please check whether you agree or disagree with each of the following statements:

MANAGING BY DESIGN QUESTIONS

1 **A certain amount of conflict is good for an organization.**

I AGREE _____ I DISAGREE _____

2 **A factory worker on the assembly line is in a low power position and should accept that he or she will have little influence over what happens.**

I AGREE _____ I DISAGREE _____

3 **When managers use politics, it usually leads to conflict and disharmony and will likely disrupt the smooth functioning of the organization.**

I AGREE _____ I DISAGREE _____

In the summer of 2013, executives from Omnicom Group Inc. and Publicis Groupe SA announced with much fanfare in Paris that the two companies were merging to create the largest advertising agency in the world. However, within a year, as we mentioned in a Chapter 4 In Practice example, the merger was off. What happened? There may have been several reasons the merger wasn't completed, but clashes over position and power were largely to blame. For one thing, the two sides couldn't agree on which company would legally be the acquirer, which held up the filing of necessary paperwork. Beyond that, each company wanted its senior executives to fill top positions in the new company. The deal was talked up as a "merger of equals," and John Wren of Omnicom and Maurice Lévy of Publicis agreed to serve as co-CEOs for the first 30 months. But both men have strong personalities, which clashed from the start. Communicating about the details of the merger grew increasingly complicated. To illustrate the conflicting communications, the CEO of a rival company said, "You have one talking Chinese and the other talking Japanese." The battle for control went on for nearly a year before Wren and Lévy issued a joint statement in May 2014 saying the deal was off. "It seems incredulous that this merger fell apart because of disagreements over roles and responsibilities," said Brian Wieser, an analyst at Pivotal Research Group.[1]

It wasn't just roles and responsibilities, of course. What was really at stake was control of the company, and each side wanted to have the most power. It isn't the first organizational project to be derailed because of power clashes between leaders. Research in Motion (RIM) once had the hottest mobile phone in the world with the Blackberry, but managers argued for years about the future direction of the company, making it hard for RIM to reinvent itself and adapt to changes in the industry. RIM, now known as BlackBerry Limited, no longer makes any smartphones but focuses on software development. It licenses the BlackBerry name to phone maker TCL, which has been struggling to bring back the iconic brand, introducing two new phones in late 2018.[2]

Conflict such as that at Research in Motion and over the Omnicom Publicis merger is a natural outcome of the close interaction of people who may have diverse opinions and values, pursue different objectives, and have differential access to information and resources within the organization. Individuals and groups use power and political activity to handle their differences and manage the inevitable

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conflicts that arise.[3] Too much conflict can be harmful to an organization. However, conflict can also be a positive force because it challenges the status quo, encourages new ideas and approaches, and leads to needed change.[4] For example, a six-year study of teams identified the ability to engage in healthy debate and discussion to be the most crucial predictor of top team performance. High-performing teams believe disagreement and conflict are essential because they lead to better solutions. Research found that teams that debate ideas have 25 percent more ideas than those in which members simply go along with others to avoid conflict.[5] Conflict is not necessarily a negative force; it results from the normal interaction of varying human interests. Within organizations, individuals and groups frequently have different interests and goals they wish to achieve through the organization. Managers can effectively use power and politics to manage conflict, get the most out of employees, enhance job satisfaction and team identification, achieve important goals, and realize high organizational performance.

Purpose of This Chapter

In this chapter we discuss the nature of conflict and the use of power and political tactics to manage and reduce conflict among individuals and groups. The notions of conflict, power, and politics have appeared in previous chapters. In Chapter 3 we talked about horizontal linkages such as task forces and teams that encourage collaboration among functional departments. Chapter 4 introduced the concept of differentiation, which means that different departments pursue different goals and may have different attitudes and values. Chapter 5 touched on conflict and power relationships among organizations. Chapter 11 discussed the emergence of subcultures, and in Chapter 13 coalition building was proposed as one way to resolve disagreements among managers and departments.

The first sections of this chapter explore the nature of intergroup conflict, characteristics of organizations that contribute to conflict, the use of a political versus a rational model of organization to manage conflicting interests, and some tactics for reducing conflict and enhancing collaboration. Subsequent sections examine individual and organizational power, the vertical and horizontal sources of power for managers and other employees, and how power is used to attain organizational goals. We also look at the trend toward empowerment, sharing power with lower-level employees. The latter part of the chapter turns to politics, which is the application of power and influence to achieve desired outcomes. We discuss ways managers increase their power and various political tactics for using power to influence others and accomplish desired goals.

14.1 Interdepartmental Conflict in Organizations

Conflict among departments and groups in organizations, called *intergroup conflict*, requires three ingredients: group identification, observable group differences, and frustration. First, employees have to perceive themselves as part of an identifiable group or department.[6] Second, there has to be an observable group difference of some form. Groups may be located on different floors of the building, members may have different social or educational backgrounds, or members may work in

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different departments. The ability to identify oneself as a part of one group and to observe differences in comparison with other groups is necessary for conflict.[7]

The third ingredient is frustration. Frustration means that if one group achieves its goal, the other will not; it will be blocked. Frustration need not be severe and only needs to be anticipated to set off intergroup conflict. Intergroup conflict will appear when one group tries to advance its position in relation to other groups. Consider what happened when Fairfax Media executives created two newsrooms—one for digital media and one for the print newspaper—at *The Sydney Morning Herald* in Australia. The two groups quickly came into conflict, with the online staff continually pushing for more coverage of celebrity news, sensational crime stories, and spicy gossip, and the traditional news staff pushing to retain the *Herald*'s focus on serious topics like the domestic economy and global politics.[8] **Intergroup conflict** can be defined as the behavior that occurs among organizational groups when participants identify with one group and perceive that other groups may block their group's goal achievement or expectations.[9] Conflict means that groups clash directly, that they are in fundamental opposition. Conflict is similar to competition but more severe. **Competition** is rivalry among groups in the pursuit of a common prize, whereas conflict presumes direct interference with goal achievement.

Intergroup conflict within organizations can occur horizontally across departments or vertically between different levels of the organization.[10] Recall the discussion from Chapter 7 of the potential conflict between the commercial logic and the social welfare logic in hybrid organizations. Managers face a challenge in uniting people in a common goal and managing conflict between people and departments focused on selling products and services for profit and those focused on helping the company's social welfare clients. In traditional organizations, the production department of a manufacturing company may have a dispute with quality control because new quality procedures reduce production efficiency. R&D managers often conflict with finance managers because the finance managers' pressure to control costs reduces the amount of funding for new R&D projects. Teammates may argue about the best way to accomplish tasks and achieve goals. Conflict can also occur between different divisions or business units in an organization.

Vertical conflict may occur when employees clash with bosses about new work methods, job assignments, or company actions. For example, white-collar employees walked out at Google and Wayfair to protest company actions that employees felt did not reflect their ethical values. Some 8,000 Amazon employees concerned about climate change signed onto a group pressuring the company to account for and reduce its emissions.[11]

Another typical area of conflict is between groups such as unions and management or franchise owners and headquarters. For example, franchise owners for McDonald's, Taco Bell, Burger King, and KFC have clashed with headquarters because of the increase of company-owned stores in neighborhoods that compete directly with franchisees.[12]

Conflict can also occur between different divisions or business units within an organization, as illustrated by the conflict between Facebook and WhatsApp described in previous chapters. After Facebook acquired the popular messaging service, WhatsApp's founders became engaged in persistent disputes with Facebook executives over issues of data privacy and commercial applications of the service. The conflict became so severe that WhatsApp's founders eventually left the company.[13] In global organizations, conflicts between regional managers and business division managers, among different divisions, or between divisions and headquarters are common because of the complexities of international business, as described

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in Chapter 6. Similar problems occur between distinct organizations. As we briefly discussed in Chapter 5, with so many companies involved in interorganizational collaboration, conflicts and shifting power relationships are inevitable.

14.1a Sources of Conflict

Some specific organizational characteristics can generate conflict. These **sources of intergroup conflict** are goal incompatibility, differentiation, task interdependence, and limited resources. These characteristics of organizational relationships are determined by the organizational structure and the contingency factors of environment, size, technology, and strategy and goals, which have been discussed in previous chapters. These characteristics, in turn, help shape the extent to which a rational model of behavior versus a political model of behavior is used to accomplish objectives.

Goal Incompatibility. The goals of each department reflect the specific objectives members are trying to achieve. The achievement of one department's goals often interferes with another department's goals, leading to conflict. University police, for example, have a goal of providing a safe and secure campus. They can achieve their goal by locking all buildings on evenings and weekends and not distributing keys. Without easy access to buildings, however, progress toward the science department's research goals will proceed slowly. On the other hand, if scientists come and go at all hours and security is ignored, police goals for security will not be met. Goal incompatibility throws the departments into conflict with each other.

ASSESS YOUR ANSWER

1 A certain amount of conflict is good for an organization.

ANSWER: *Agree.* Conflict is inevitable in all human relationships, including those in organizations, and is often a good thing. Some conflict can be healthy because it contributes to diverse thinking and leads to change. If there is no conflict whatsoever, there is likely no growth and development either.

In business organizations, the IT department is frequently in conflict with managers of business departments because of goal incompatibility. Business managers often want new devices or new systems and don't understand why the CIO turns down the requests. The CIO, however, is responsible for making sure any changes don't jeopardize the safety and security of the company's overall IT systems and processes.[14] The potential for conflict is perhaps greater between marketing and manufacturing than between other departments because the goals of these two departments are frequently at odds. Exhibit 14.1 shows examples of goal conflict between typical marketing and manufacturing departments. Marketing strives to increase the breadth of the product line to meet customer tastes for variety. A broad product line means short production runs, so manufacturing has to bear higher costs.[15] Typical areas of goal conflict are quality, cost control, and new products or services. Goal incompatibility is probably the greatest cause of intergroup conflict in organizations.[16]

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EXHIBIT 14.1
Marketing–Manufacturing Areas of Potential Goal Conflict

Goal Conflict	MARKETING Versus MANUFACTURING	
	Operative Goal Is Customer Satisfaction	Operative Goal Is Production Efficiency
Conflict Area	**Typical Comment**	**Typical Comment**
1. Breadth of product line	"Our customers demand variety."	"The product line is too broad—all we get are short, uneconomical runs."
2. New product introduction	"New products are our lifeblood."	"Unnecessary design changes are prohibitively expensive."
3. Product scheduling	"We need faster response. Our customer lead times are too long."	"We need realistic commitments that don't change like wind direction."
4. Physical distribution	"Why don't we ever have the right merchandise in inventory?"	"We can't afford to keep huge inventories."
5. Quality	"Why can't we have reasonable quality at lower cost?"	"Why must we always offer options that are too expensive and offer little customer utility?"

Sources: Based on Benson S. Shapiro, "Can Marketing and Manufacturing Coexist?" *Harvard Business Review* 55, September–October 1977, 104–114; and Victoria L. Crittenden, Lorraine R. Gardiner, and Antonie Stam, "Reducing Conflict Between Marketing and Manufacturing," *Industrial Marketing Management* 22 (1993), 299–309.

Differentiation. *Differentiation* was defined in Chapter 4 as "the differences in cognitive and emotional orientations among managers in different functional departments." Functional specialization requires people with specific education, skills, attitudes, and time horizons. For example, people may join a sales department because they have ability and aptitude consistent with sales work. After becoming members of the sales department, they are influenced by departmental norms and values.

Departments or divisions within an organization often differ in values, attitudes, and standards of behavior, and these subcultural differences lead to conflicts.[17] Consider an encounter between a sales manager and a research and development (R&D) scientist about a new product:

> *The sales manager may be outgoing and concerned with maintaining a warm, friendly relationship with the scientist. He may be put off because the scientist seems withdrawn and disinclined to talk about anything other than the problems in which he is interested. He may also be annoyed that the scientist seems to have such freedom in choosing what he will work on. Furthermore, the scientist is probably often late for appointments, which, from the salesman's point of view, is no way to run a business. Our scientist, for his part, may feel uncomfortable because the salesman seems to be pressing for immediate answers to technical questions that will take a long time to investigate. All the discomforts are concrete manifestations of the relatively wide differences between these two men in respect to their working and thinking styles.*[18]

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Recognize that some interdepartmental conflict is natural and can benefit the organization. Associate the organizational design characteristics of goal incompatibility, differentiation, task interdependence, and resource scarcity with greater conflict among groups. Expect to devote more time and energy to resolving conflict in these situations.

Task Interdependence. Task interdependence refers to the dependence of one unit on another for materials, resources, or information. As described in Chapter 8, *pooled interdependence* means there is little interaction; *sequential interdependence* means the output of one department goes to the next department; and *reciprocal interdependence* means that departments mutually exchange materials and information.[19]

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Generally, as interdependence increases, the potential for conflict increases.[20] In the case of pooled interdependence, units have little need to interact. Conflict is at a minimum. Sequential and reciprocal interdependence require employees to spend time coordinating and sharing information. Employees must communicate frequently, and differences in goals or attitudes will surface. Conflict is especially likely to occur when agreement is not reached about the coordination of services to each other. Greater interdependence means departments often exert pressure for a fast response because departmental work has to wait on other departments.[21]

Limited Resources. Another major source of conflict involves competition between groups for what members perceive as limited resources.[22] Organizations have limited money, physical facilities, staff resources, and human resources to share among departments. In their desire to achieve goals, groups want to increase their resources. This throws them into conflict. Managers may develop strategies, such as inflating budget requirements or working behind the scenes, to obtain a desired level of resources.

Resources also symbolize power and influence within an organization. The ability to obtain resources enhances prestige. Departments typically believe they have a legitimate claim on additional resources. However, exercising that claim results in conflict. Conflict over limited resources also occurs frequently among government, nonprofit, and membership organizations. Consider the nation's labor unions, which are fighting each other these days for members and dues as much or more than they are fighting corporate management. Shrinking resources and goal incompatibility are also involved in a conflict that has been playing out at the National Rifle Association.

IN PRACTICE

National Rifle Association (NRA)

Wayne LaPierre is still CEO of the National Rifle Association (NRA), but he has had to fight to keep his position. LaPierre, who has been the organization's chief since 1991, came into conflict with the NRA's president, Oliver North, who led a group trying to oust the long-term CEO. The conflict occurred amid a complex mix of events including declining contributions, perceived excessive spending by the CEO, legal battles, a growing well-funded gun control movement, and allegations of financial impropriety that threaten the NRA's non-profit status. Soon after he was installed as president, North began pushing for LaPierre to resign, and the two men began an intense internal battle for control.

In the end, North didn't have the support he needed to oust LaPierre and he announced that he would not seek a second term as president. The NRA's second-in-command, chief lobbyist Chris Cox, also resigned in June 2019 after being suspended based on accusations of involvement in the efforts to oust the top leader. The turmoil isn't over though. The NRA continues to lose support because of allegations of financial misdeeds and other misconduct. At least three congressional committees are investigating the group, in addition to an investigation by New York Attorney General Letitia James.[23]

14.1b Rational Versus Political Model

The sources of intergroup conflict are listed in Exhibit 14.2. The degree of goal incompatibility, differentiation, interdependence, and competition for limited resources determines whether a rational or political model of behavior is used within the organization to accomplish goals.

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EXHIBIT 14.2
Sources of Conflict and Use of Rational Versus Political Model

Sources of Potential Intergroup Conflict	When Conflict Is Low, Rational Model Describes Organization		When Conflict Is High, Political Model Describes Organization
• *Goal incompatibility*	*Consistent across participants*	*Goals*	*Inconsistent, pluralistic within the organization*
• *Differentiation*	*Centralized*	*Power and control*	*Decentralized, shifting coalitions and interest groups*
• *Task interdependence*	*Orderly, logical, rational*	*Decision process*	*Disorderly, result of bargaining and interplay among interests*
• *Limited resources*	*Norm of efficiency*	*Rules and norms*	*Free play of market forces; conflict is legitimate and expected*
	Extensive, systematic, accurate	*Information*	*Ambiguous; information used and withheld strategically*

When goals are in alignment, there is little differentiation, departments are characterized by pooled interdependence, and resources seem abundant, managers can use a **rational model** of organization, as outlined in Exhibit 14.2. As with the rational approach to decision making described in Chapter 13, the rational model of organization is an ideal that is not fully achievable in the real world, though managers strive to use rational processes whenever possible. In the rational organization, behavior is not random or accidental. Goals are clear and choices are made in a logical way. When a decision is needed, the goal is defined, alternatives are identified, and the choice with the highest probability of success is selected. The rational model is also characterized by centralized power and control, extensive information systems, and an efficiency orientation.[24]

The opposite view of organizational processes is the **political model**, also described in Exhibit 14.2. When differences are great, organization groups have separate interests, goals, and values. Disagreement and conflict are normal, so power and influence are needed to reach decisions. Groups will engage in the push and pull of debate to decide goals and reach decisions. Information is ambiguous and incomplete. The political model describes the way organizations operate much of the time. Although managers strive to use a rational approach, the political model prevails because each department has different interests it wants met and different goals it wants to achieve. Purely rational procedures do not work for many circumstances.

Typically, both rational and political processes are used in organizations. Neither the rational model nor the political model characterizes things fully, but each will be used some of the time. Managers may strive to adopt rational procedures but will find that politics is needed to accomplish objectives. When managers fail to effectively apply the political model, conflict can escalate and prevent the organization from achieving important outcomes.

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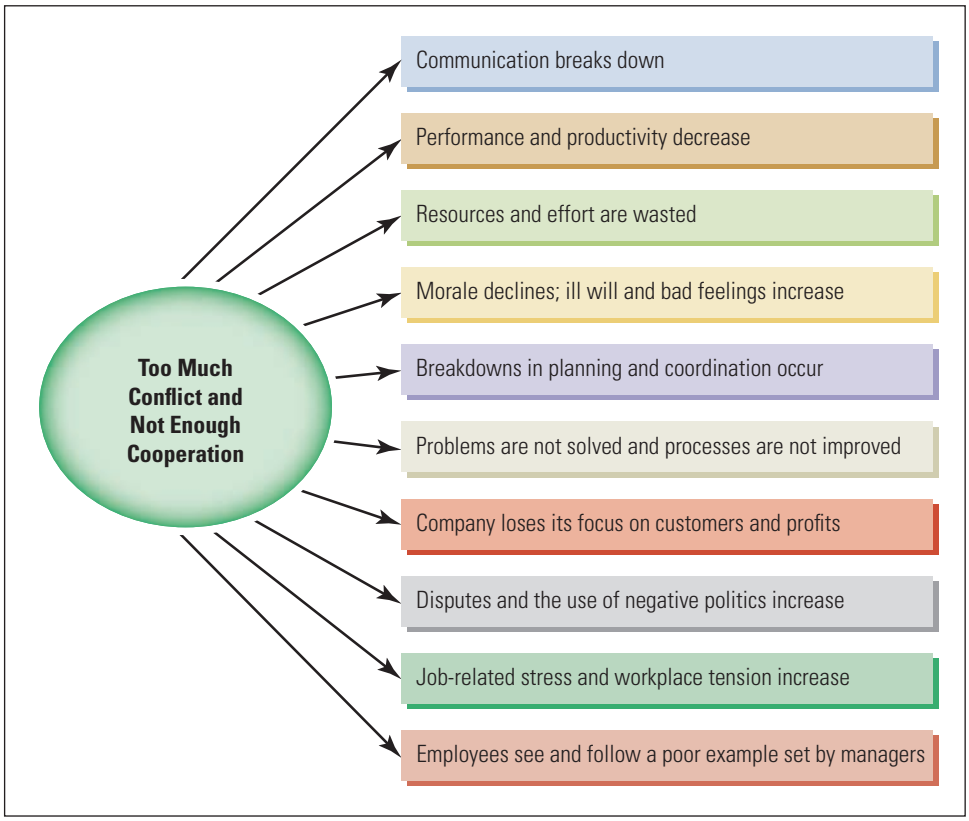
EXHIBIT 14.3
Top 10 Problems from Too Much Conflict


Too Much Conflict and Not Enough Cooperation
Communication breaks down
Performance and productivity decrease
Resources and effort are wasted
Morale declines; ill will and bad feelings increase
Breakdowns in planning and coordination occur
Problems are not solved and processes are not improved
Company loses its focus on customers and profits
Disputes and the use of negative politics increase
Job-related stress and workplace tension increase
Employees see and follow a poor example set by managers

Source: Based on survey results reported in Clinton O. Longenecker and Mitchell Neubert, "Barriers and Gateways to Management Cooperation and Teamwork," *Business Horizons*, November–December 2000, 37–44.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Use a political model of organization when differences among groups are great, goals are ill-defined, or there is competition for limited resources. Use the rational model when alternatives are clear, goals are defined, and managers can estimate the outcomes accurately. In these circumstances, coalition building, cooptation, or other political tactics are not needed and will not lead to better decisions.

Consider what happened at Premio Foods, where CEO Marc Cinque and Charlean Gmunder, the vice president of operations, tried to use a rational model but discovered that a political model was needed. Gmunder suggested implementing a new computerized system that would overhaul the company's outdated method of forecasting and ordering and require changes in every department. She presented facts and statistics to Cinque showing that the system would increase annual cash flow by $500,000 and save up to $150,000 a year by cutting wasted material. But even though "the numbers made it clear," Cinque hesitated primarily because many of his senior managers expressed strong objections. After Cinque finally decided to go with the system, the conflict intensified. Gmunder couldn't get the information she needed from some managers, and some would show up late to meetings or skip them altogether. Gmunder had failed to build a coalition to support the new system. To salvage the project, Cinque formed a team that included senior managers from various departments to discuss their concerns and involve them in determining how the new system should work.[25]

Most organizations have at least moderate conflict among departments or other organizational groups. When conflict becomes too strong and managers do not work together, it creates many problems for organizations. Exhibit 14.3 lists the top 10 problems caused by a lack of cooperation that were identified by one survey of managers.[26]

14.1c Tactics for Enhancing Collaboration

Good managers strive to minimize conflict and prevent it from hurting organizational performance and goal attainment. Effective conflict management can have a direct, positive effect on team and organization performance.[27] Thus,

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managers consciously apply a variety of techniques to handle conflict and stimulate cooperation and collaboration among departments to support the attainment of organizational goals. **Tactics for enhancing collaboration** include the following:

1. *Create integration devices.* As described in Chapter 3, teams, task forces, and project managers who span the boundaries between departments can be used as integration devices. Bringing together representatives from conflicting departments in joint problem-solving teams is an effective way to enhance collaboration because representatives learn to understand each other's point of view.[28] Sometimes a full-time integrator is assigned to achieve cooperation and collaboration by meeting with members of the respective departments and exchanging information. The integrator has to understand each group's problems and must be able to move both groups toward a solution that is mutually acceptable.[29]

   Teams and task forces reduce conflict and enhance cooperation because they integrate people from different departments. Integration devices can also be used to enhance cooperation between labor and management. **Labor-management teams**, which are designed to increase worker participation and provide a cooperative model for solving union-management problems, are increasingly being used at companies such as Goodyear, Ford Motor Company, and Alcoa. At the International Specialty Products Corporation plant in Calvert City, Kentucky, a union-management partnership enabled the company to improve quality, reduce costs, and enhance profitability. The plant leadership team is made up of two managers and two union members, and each of the plant's seven operating areas is jointly led by a management representative and a union representative.[30] Although unions continue to battle over traditional issues such as wages, these integration devices are creating a level of cooperation that many managers would not have believed possible just a few years ago.
2. *Use confrontation and negotiation.* **Confrontation** occurs when parties in conflict directly engage one another and try to work out their differences. **Negotiation** is the bargaining process that often occurs during confrontation and that enables the parties to systematically reach a solution. Negotiation is frequently an important form of conflict mediation used in business partnerships, joint ventures, and other alliances, particularly those on a global scale. In Chapter 6, for example, we discussed how executives at Renault, Nissan, and Mitsubishi engaged in negotiations and recommitted to a "win-win-win" operation.[31] Confrontation and negotiation bring appointed representatives from the divisions, departments, or organizations together to work out a serious dispute. Confrontation and negotiation involve some risk. There is no guarantee that discussions will focus on a conflict or that emotions will not get out of hand. However, if members are able to resolve the conflict on the basis of face-to-face discussions, they will find new respect for each other, and future collaboration becomes easier. The beginnings of relatively permanent attitude change are possible through direct negotiation.

   Confrontation and negotiation are successful when managers engage in a *win-win strategy*. Win-win means both sides adopt a positive attitude and strive to resolve the conflict in a way that will benefit each other.[32] If the negotiations deteriorate into a strictly win-lose strategy (each group wants to defeat the other), the confrontation will be ineffective. The differences between win-win and win-lose strategies of negotiation are shown in Exhibit 14.4. With a win-win strategy—which includes defining the problem as mutual, communicating openly, and avoiding threats—understanding can be changed while the dispute is resolved.

   One type of negotiation, used to resolve a disagreement between workers and management, is referred to as **collective bargaining**. The bargaining process is usually accomplished through a union and results in an agreement that specifies each party's responsibilities for the next two to three years.

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EXHIBIT 14.4
Negotiating Strategies

Win-Lose Strategy	Win-Win Strategy
1. Define the problem as a win-lose situation.	1. Define the conflict as a mutual problem.
2. Pursue own group's outcomes.	2. Pursue joint outcomes.
3. Force the other group into submission.	3. Find creative agreements that satisfy both groups.
4. Be deceitful, inaccurate, and misleading in communicating the group's needs, goals, and proposals.	4. Be open, honest, and accurate in communicating the group's needs, goals, and proposals.
5. Use threats (to force submission).	5. Avoid threats (to reduce the other's defensiveness).
6. Communicate strong commitment (rigidity) regarding one's position.	6. Communicate flexibility of position.

Source: Adapted from David W. Johnson and Frank P. Johnson, *Joining Together: Group Theory and Group Skills* (Englewood Cliffs, NJ: Prentice-Hall, 1975), 182–183.

3. *Schedule intergroup consultation.* When conflict is intense and enduring, and department members are suspicious and uncooperative, top managers may intervene as third parties to help resolve the conflict or bring in third-party consultants from outside the organization.[33] This process, sometimes called *workplace mediation,* is a strong intervention to reduce conflict because it involves bringing the disputing parties together and allowing each side to present its version of the situation. The technique has been developed by such psychologists as Robert Blake, Jane Mouton, and Richard Walton.[34]

   Department members attend a workshop, which may last for several days, away from day-to-day work problems. This approach is similar to the organization development (OD) approach described in Chapter 12. The conflicting groups are separated, and each group is invited to discuss and make a list of its perceptions of itself and the other group. Group representatives publicly share these perceptions, and together the groups discuss the results. Intergroup consultation can be quite demanding for everyone involved, but if handled correctly, these sessions can help department employees understand each other much better and lead to improved attitudes and better working relationships for years to come.
4. *Practice member rotation.* Rotation means that individuals from one department can be asked to work in another department on a temporary or permanent basis. The advantage is that individuals become submerged in the values, attitudes, problems, and goals of the other department. In addition, individuals can explain the problems and goals of their original departments to their new colleagues. This enables a frank, accurate exchange of views and information. Rotation works slowly to reduce conflict but is very effective for changing the underlying attitudes and perceptions that promote conflict.[35] Some years ago, Ben Horowitz, co-founder of venture capital firm Andreessen Horowitz, used what he calls the *Freaky Friday* Management Technique as a creative solution to a difficult conflict between the Sales Engineering and Customer Support departments.

IN PRACTICE
The *Freaky Friday* Management Technique

When the Customer Support and Sales Engineering teams went to war with one another, Ben Horowitz didn't know what to do. Both teams were made up of first-rate people and were led by excellent managers. The sales engineers complained that customer support refused to fix problems, did not respond with urgency, and generally failed to provide the kind of service that led to customer satisfaction. On the other hand, customer support said the sales engineers didn't listen to suggested fixes for problems and made the support team's job harder by assigning every problem top priority. The teams just could not get along. But for the company to function, they had to work together smoothly and constantly.

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Horowitz happened to watch the movie *Freaky Friday* during this time period and came up with an idea. In the movie, a mother and daughter become completely frustrated with one another's lack of understanding and appreciation and wish that they could switch places. Because this is a movie, they miraculously do just that! Throughout the rest of the movie, "by being inside each other's bodies, both characters develop an understanding of the challenges the other faces," Horowitz writes. He wonders if the same thing could work with his sales engineering and customer support managers. The next day, he tells the managers they will be switching places in the company. Like the characters in *Freaky Friday,* they will keep their own minds but get new bodies.

The reaction he got was equivalent to Jamie Lee Curtis and Lindsay Lohan screaming in horror in the film. But after a week of experiencing the other's challenges, the managers discovered the core issues that were leading to conflict between the two departments. Moreover, they quickly implemented some simple solutions that resolved disputes and got people working together harmoniously. "From that day to the day we sold the company," Horowitz says, those two teams "worked better together than any other major groups in the company—all thanks to *Freaky Friday,* perhaps the most insightful management training film ever made."[36]

5. *Create shared mission and superordinate goals.* Another strategy is for top management to create a shared mission and establish superordinate goals that require cooperation among departments.[37] As discussed in Chapter 11, organizations with strong, constructive cultures, where employees share a larger vision for their company, are more likely to have a united, cooperative workforce. Studies have shown that when employees from different departments see that their goals are linked, they will openly share resources and information.[38] To be effective, superordinate goals must be substantial, and employees must be granted the time and incentives to work cooperatively in pursuit of the superordinate goals rather than departmental subgoals.

BRIEFCASE

As an organization manager, keep these guidelines in mind:

If conflict becomes too strong, use tactics for enhancing collaboration, including integration devices, confrontation, intergroup consultation, member rotation, and superordinate goals. Select the technique that fits the organization and the conflict.

REMEMBER THIS

- Conflict, power, and politics are natural outcomes of organizing. Sources of conflict include goal incompatibility, differentiation, task interdependence, and limited resources.
- Differences in goals, backgrounds, and tasks are necessary for organizational excellence, but these differences can throw groups into conflict. Managers use power and politics to manage and resolve conflict.
- The rational model of organization assumes that organizations have specific goals and that problems can be logically solved. The other view, the political model of organization, assumes that the goals of an organization are not specific or agreed upon. Managers and departments have different values and interests that throw them into conflict, so decisions are made on the basis of power and political influence. Bargaining, negotiation, persuasion, and coalition building decide outcomes.
- Although conflict and political behavior can be used for beneficial purposes, managers also strive to enhance collaboration so that conflict between groups does not become too strong. Tactics for enhancing collaboration include integration devices, confrontation and negotiation, intergroup consultation, member rotation, and shared mission and superordinate goals.

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14.2 Power and Organizations

Power is an intangible force in organizations. It cannot be seen, but its effect can be felt. *Power* is often defined as the potential ability of one person (or department) to influence other people (or departments) to carry out orders[39] or to do something they would not otherwise have done.[40] Other definitions stress that power is the ability to achieve goals or outcomes that power holders desire.[41] The achievement of desired outcomes is the basis of the definition used here: **power** is the ability of one person or department in an organization to influence other people to bring about desired outcomes. It is the potential to influence others within the organization with the goal of attaining desired outcomes for power holders. Powerful managers, for instance, are often able to get bigger budgets for their departments, more favorable production schedules, and more control over the organization's agenda.[42]

Power exists only in a relationship between two or more people, and it can be exercised in either vertical or horizontal directions. The source of power often derives from an exchange relationship in which one person, department, or organization provides scarce or valued resources to other people, departments, or organizations. When one is dependent on another, a power relationship emerges in which the side with the resources has greater power.[43] Power holders can achieve compliance with their requests.

As an illustration of dependence on one's resources increasing one's power, consider some of the conditions Walt Disney Studios required movie theaters dependent on it for movies to agree to if they wanted to show the hit film *Star Wars: The Last Jedi*. Not only were theaters required to screen the film for at least four weeks, they also had to agree that before the show, customers could purchase only *Star Wars*-related refreshments, that no one would be allowed to leave the theatre during the screening, and that the theatre would run only duds on its other screens while showing *Star Wars*.[44]

14.2a Individual Versus Organizational Power

In popular literature, power is often described as a personal characteristic, and a frequent topic is how one person can influence or dominate another person.[45] Most discussions of power include five types,[46] and these can be categorized as either *hard power* or *soft power*.

Individual Hard Power. Hard power is power that stems largely from a person's position of authority and includes legitimate, reward, and coercive power. *Legitimate power* is the authority granted by the organization to the formal management position a manager holds. Once a person has been selected as a supervisor, most employees understand that they are obligated to follow his or her direction with respect to work activities. Subordinates accept this source of power as legitimate, which is why they comply. *Reward power* stems from the ability to bestow rewards—a promotion, raise, or pat on the back—to other people. Managers can use rewards to influence subordinates' behavior. The opposite of reward power is *coercive power.* It refers to the authority to punish or recommend punishment. Managers have coercive power when they have the right to fire or demote employees, criticize them, or withhold pay increases. If an employee does not perform as expected, the manager has the coercive power to reprimand him, put a negative letter in his file, deny him a raise, and hurt his chances for a promotion.

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Personal Soft Power. Managers also use soft power, including expert power and referent power. Soft power is based on personal characteristics and interpersonal relationships more than on a position of authority. *Expert power* derives from a person's greater skill or knowledge about the tasks being performed. When someone is a true expert, others go along with recommendations because of his or her superior knowledge. *Referent power* is derived from personal characteristics that command others' identification, respect, and admiration so that they wish to emulate that individual. When employees admire a supervisor because of the way that she deals with them, the influence is based on referent power. Soft power such as expert and referent power is becoming increasingly important as more businesses are run by teams of workers who are less tolerant of authoritarian management.[47]

Organizational Power. Each of these sources may be used by individuals within organizations, but power in organizations is often the result of structural characteristics.[48] Organizations are large, complex systems that may contain hundreds, even thousands, of people. These systems have a formal hierarchy in which some tasks are more important regardless of who performs them. In addition, some positions have access to more information and greater resources, or their contribution to the organization is more critical. Executive assistants to CEOs, for example, have tremendous power because they have direct access to the top executive, have information other people don't have, and can determine who gets to talk to the boss and who doesn't. John Manuck, CEO of Techmer PM LLC, says he depends on his assistant Nicole Brannick to tell him who he needs to speak with urgently and who can wait.[49]

14.2b Power Versus Authority

Anyone in an organization can exercise power to achieve desired outcomes. For example, when the Discovery Channel wanted to extend its brand beyond cable television, Tom Hicks began pushing for a focus on the Internet. Even though Discovery's CEO favored exploring interactive television instead, Hicks organized a grassroots campaign that eventually persuaded the CEO to focus on Internet publishing, indicating that Hicks had power within the organization. Eventually, Hicks was put in charge of running Discovery Channel Online.[50]

The concept of formal authority is related to power but is narrower in scope. **Authority** is also a force for achieving desired outcomes, but only as prescribed by the formal hierarchy and reporting relationships. Three properties identify authority:

1. *Authority is vested in organizational positions.* People have authority because of the positions they hold, not because of personal characteristics or resources.
2. *Authority is accepted by subordinates.* Subordinates comply because they believe position holders have a legitimate right to exercise authority.[51] In most North American organizations, employees accept that supervisors can legitimately tell them what time to arrive at work, the tasks to perform while they're there, and what time they can go home.
3. *Authority flows down the vertical hierarchy.*[52] Authority exists along the formal chain of command, and positions at the top of the hierarchy are vested with more formal authority than are positions at the bottom.

Formal authority is exercised downward along the hierarchy. Organizational power, on the other hand, can be exercised upward, downward, and horizontally in organizations. In addition, managers can have formal authority but little real

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power. Kevin Sharer, who now teaches corporate strategy at Harvard Business School, says that when he looks back on his three years as executive vice president of marketing at telecommunications company MCI, he can now see why those years were so frustrating. Sharer had great ideas for changing things, but he failed to build credibility with his new colleagues, and his ideas and suggestions went unheeded despite his impressive job title. Sharer later spent 12 years as Chairman and CEO of biotechnology firm Amgen Inc., where he learned to effectively use both hard and soft power.[53] In the following sections we examine how employees throughout the organization can tap into both vertical and horizontal sources of power.

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As an organization manager, keep this guideline in mind:

Understand and use the vertical sources of power in organizations, including formal position, resources, control of information, and network centrality.

14.2c Vertical Sources of Power

All employees along the vertical hierarchy have access to some sources of power. Although a large amount of power is typically allocated to top managers by the organization structure, people throughout the organization often obtain power disproportionate to their formal positions and can exert influence in an upward direction, as Tom Hicks did at the Discovery Channel. There are four major sources of vertical power: formal position, resources, control of information, and network centrality.[54]

Formal Position. Certain rights, responsibilities, and prerogatives accrue to top positions. People throughout the organization accept the legitimate right of top managers to set goals, make decisions, and direct activities. This is *legitimate power,* as defined earlier. A good example of the use of formal position power comes from 21st Century Fox, where Rupert Murdoch has put his sons Lachlan and James in charge of running the company. The brothers used their formal power quickly to make changes, including firing some film executives, overhauling foreign television operations, and replacing the Republican lobbying executive hired by their father with a Democratic one.[55]

The amount of power provided to middle managers and lower-level participants can be built into the organization's structural design. The allocation of power to middle managers and staff is important because power enables people to be productive. When job tasks are nonroutine and when employees participate in self-directed teams and problem-solving task forces, this encourages them to be flexible and creative and to use their own discretion. Allowing people to make their own decisions increases their power.

Power is also increased when a position encourages contact with high-level people. Access to powerful people and the development of a relationship with them provide a strong base of influence.[56] For example, D'Andra Galarza, executive assistant for a president at NBCUniversal, says people treat her with kid gloves and are always trying to wheedle information out of her. "People know I know everything," she says. "If I was working for a VP, it wouldn't be that way."[57]

The logic of designing positions for more power assumes that an organization does not have a limited amount of power to be allocated among high-level and low-level employees. The total amount of power in an organization can be increased by designing tasks and interactions along the hierarchy so everyone can exert more influence. If the distribution of power is skewed too heavily toward the top, research suggests that the organization will be less effective.[58]

Resources. Organizations allocate huge amounts of resources. Buildings are constructed, salaries are paid, and equipment and supplies are purchased. Each year, new resources are allocated in the form of budgets. These resources are allocated downward from top managers. Top managers often own stock, which gives them property rights over resource allocation. In many of today's organizations, however, employees throughout the organization also share in ownership, which increases their power.

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In most cases, top managers control the resources and, hence, can determine their distribution. Resources can be used as rewards and punishments, which are additional sources of power. Resource allocation creates a dependency relationship. Lower-level participants depend on top managers for the financial and physical resources needed to perform their tasks. Top management can exchange resources in the form of salaries and bonuses, personnel, promotions, and physical facilities for compliance with the outcomes they desire.

Control of Information. The control of information can be a significant source of power. Managers recognize that information is a primary business resource and that by controlling what information is collected, how it is interpreted, and how it is shared, they can influence how decisions are made.[59] In many of today's companies, information is openly and broadly shared, which increases the power of people throughout the organization.

However, top managers generally have access to more information than do other employees. This information can be released as needed to shape the decisions of other people. In one healthcare organization, Clark Ltd., the senior information technology manager controlled information given to the board of directors and thereby influenced the board's decision to eliminate the existing computer systems of the business units and move all the software onto one new IT platform. She knew this was the only way to bring costs into line, but it would cause short-term problems for the business unit managers who were likely to resist.[60] The board of directors had formal authority to decide whether to adopt the plan for unifying IT systems and from which company the new system would be purchased. The management services group was asked to recommend which of six companies should receive the order. Kate Kenny was in charge of the management services group, and Kenny disagreed with other managers about which system to purchase. As shown in Exhibit 14.5, other managers had to go through Kenny to have their viewpoints

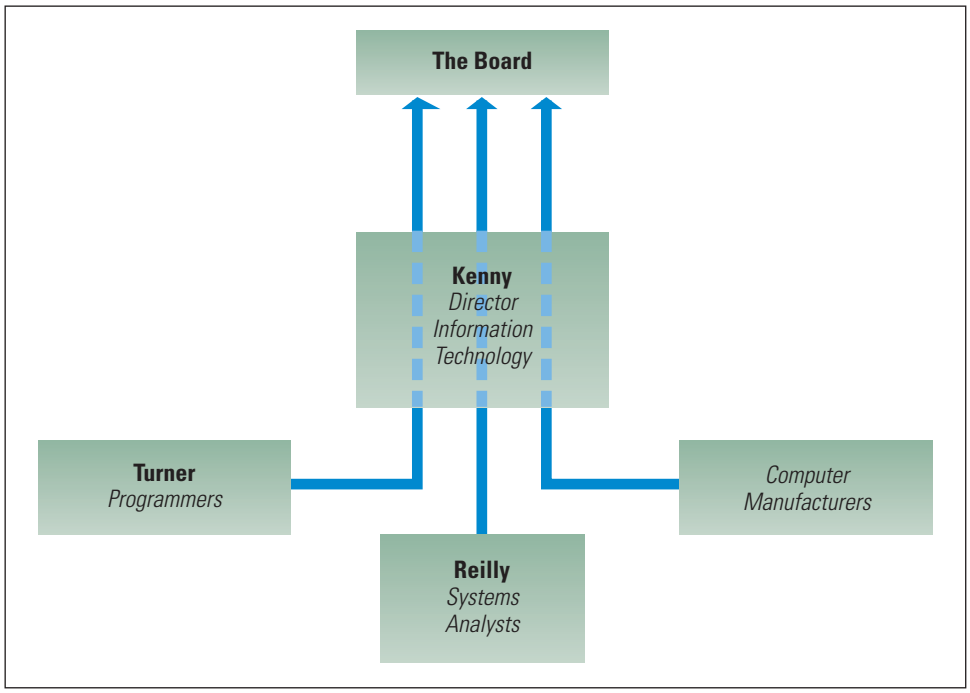

EXHIBIT 14.5
Information Flow for IT System Decision at Clark Ltd.

Source: Andrew M. Pettigrew, *The Politics of Organizational Decision-Making* (London: Tavistock, 1973), 235. Reprinted by permission of the author.

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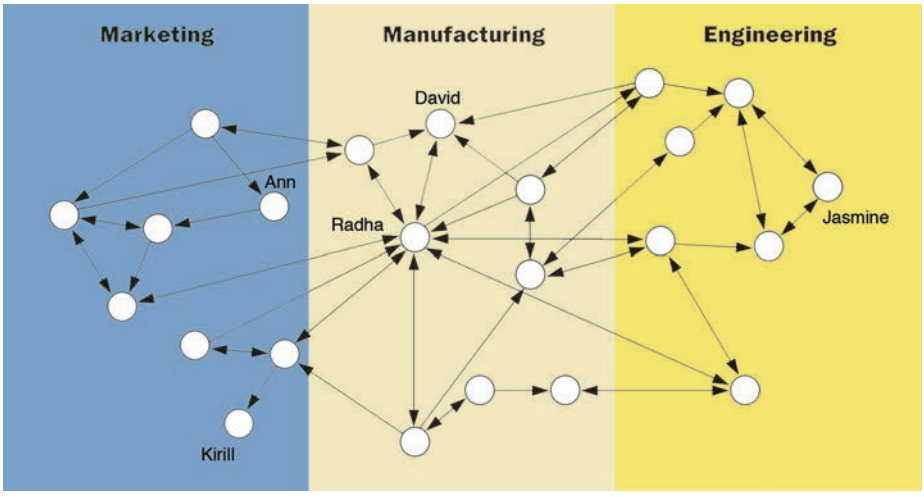
heard by the board. Kenny shaped the board's thinking toward selecting the system she preferred by controlling information given to them.

Middle managers and lower-level employees may also have access to information that can increase their power. An assistant to a senior executive can often control information that other people want and will thus be able to influence those people. Top executives depend on people throughout the organization for information about problems or opportunities. Middle managers or lower-level employees may manipulate the information they provide to top managers in order to influence decision outcomes.

Network Centrality. **Network centrality** means being centrally located in the organization and having access to information and people that are critical to the company's success. Managers as well as lower-level employees are more effective and more influential when they put themselves at the center of a communication network, building connections with people throughout the company. For example, in Exhibit 14.6, Radha has a well-developed communication network, sharing information and assistance with many people across the marketing, manufacturing, and engineering departments. Contrast Radha's contacts with those of Jasmine or Kirill. Who do you think is likely to have greater access to resources and more influence in the organization? A real-world example of network centrality is B. J. Shannon, former head of customer relations at employee-engagement company TINYPulse, who recently moved into senior management at a larger company. Shannon's former boss at TINYpulse says he built positive relationships with people throughout the company, showing an interest in them and helping them develop their skills and reach their goals. Shannon made a point of praising colleagues' good work, sending out five or more "cheers" a week on the company's internal messaging system.[61]

People at all levels of the hierarchy can use the idea of network centrality to accomplish goals and be more successful. People can increase their network centrality by becoming knowledgeable and expert about certain activities or by taking on difficult tasks and acquiring specialized knowledge that makes them indispensable to managers above them. People who show initiative, work beyond what is expected, take on undesirable but important projects, and show interest in learning about the company and industry often find themselves with influence. Consider the following example.

EXHIBIT 14.6
An Illustration of Network Centrality



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IN PRACTICE

Jay Bower, Crossbow Group

Jay Bower is president of marketing-services firm Crossbow Group today, but he learned about power and influence years ago as an entry-level marketing analyst at a retail company.

Soon after taking the job, Bower heard that the CEO wanted an analysis of data from an unexpectedly popular customer discount program. The IT department was already overwhelmed and no one had time to do it, so Bower asked the company's CIO to teach him some basic analytical skills and took on doing the job himself. Even though he spent long hours squeezing in the work while keeping up with his regular job, Bower gave credit for the completed analysis to his boss and the CIO. It paid off, though. Bower was promoted three times in his three and a half years with the company.

Today, Bower advises new hires at Crossbow to seek out opportunities. "Look for the thing nobody knows how to do or wants to do, jump in with both feet and do whatever it takes to solve the problem," is his advice for gaining power and influence.[62]

2 A factory worker on the assembly line is in a low power position and should accept that he or she will have little influence over what happens.

ASSESS YOUR ANSWER

ANSWER: *Disagree.* Although an assembly line worker typically has little formal power and authority, all employees have access to some sources of power. It is up to the individual to network or gather information to expand his or her power in the organization. In addition, when employees band together, they can have a tremendous amount of power. Managers can't accomplish goals unless employees cooperate and do the work they're supposed to do.

People. Top leaders often increase their power by surrounding themselves with a group of loyal executives.[63] Loyal managers keep the leader informed and in touch with events and report possible disobedience or troublemaking in the organization. Top executives can use their central positions to build alliances and exercise substantial power when they have a management team that is fully in support of their decisions and actions.

Many top executives strive to build a cadre of loyal and supportive managers to help them achieve their goals for the organization. Smart managers also actively work to build bridges and win over potential opponents. Gary Loveman, who left a position as associate professor at Harvard Business School to be the chief operating officer of casino company Harrah's (now Caesars Entertainment), provides a good example. Some Harrah's executives, including the CFO, resented Loveman's appointment and could have derailed his plans for the company. Because he knew the CFO's information, knowledge, and support would be critical for accomplishing his plans, Loveman made building a positive relationship with the CFO a priority. He stopped by his office frequently to talk, kept him informed about what he was doing and why, and took care to involve him in important meetings and decisions. Building positive relationships enabled Loveman to accomplish goals that eventually led to him being named CEO in 2003 and he continued to serve as CEO of Caesars until 2015.[64]

This idea works for lower-level employees and managers too. Lower-level people have greater power when they have positive relationships and connections with higher-ups. By being loyal and supportive of their bosses, employees sometimes gain favorable status and exert greater influence.

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As an organization manager, keep these guidelines in mind:

Do not leave lower organization levels powerless. If vertical power is too heavy in favor of top management, empower lower levels by giving people the tools they need to perform better: information, knowledge and skills, and the power to make substantive decisions.

14.2d The Power of Empowerment

In forward-thinking organizations, top managers want lower-level employees to have greater power so they can do their jobs more effectively. These managers intentionally push power down the hierarchy and share it with employees to enable them to achieve goals. **Empowerment** is power sharing, the delegation of power or authority to subordinates in an organization.[65] Increasing employee power improves morale, heightens motivation for task accomplishment, and prevents petty interpersonal rivalries. "When people feel powerless, they behave in petty ways," says management expert Rosabeth Moss-Kanter. "They become rule-minded and are overcontrolling because they are trying to grab hold of some little piece of the world that they do control . . . ."[66] Empowered employees can improve their own effectiveness, choosing how to do a task and using their creativity.[67]

Empowering employees involves giving them three elements that enable them to act more freely to accomplish their jobs: information, knowledge, and power.[68]

1. *Employees receive information about company performance.* In companies where employees are fully empowered, all employees have access to all financial and operational information.
2. *Employees have knowledge and skills to contribute to company goals.* Companies use training programs and other development tools to help people acquire the knowledge and skills they need to contribute to organizational performance.
3. *Employees have the power to make substantive decisions.* Empowered employees have the authority to directly influence work procedures and organizational performance, such as through quality circles or self-directed work teams.

Many of today's organizations are implementing empowerment programs, but they are empowering employees to varying degrees. At some companies, empowerment means encouraging employees' ideas while managers retain final authority for decisions; at others, it means giving people almost complete freedom and power to make decisions and exercise initiative and imagination.[69] The continuum of empowerment can run from a situation in which front-line employees have almost no discretion, such as on a traditional assembly line, to full empowerment, where employees even participate in formulating organizational strategy. There are several examples of organizations that push empowerment to the maximum. At W. L. Gore & Associates, for example, everyone had a role in helping select Terri Kelly as the company's CEO. Menlo Innovations lets everyone vote yes or no on potential job candidates. CEO Rich Sheridan says he overruled some staff choices in the past, but he learned to stick with the vote. "Because the team picked you, they are not going to let you fail," Sheridan says.[70] Other examples of full empowerment are tomato processor Morning Star, which was described in Chapter 1, and the holacracy example of Zappos described in Chapter 3.

14.2e Horizontal Sources of Power

Horizontal power pertains to relationships across departments, divisions, or other units. All vice presidents are usually at the same level on the organization

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chart. Does this mean each department has the same amount of power? No. Horizontal power is not defined by the formal hierarchy or the organization chart. Each department makes a unique contribution to organizational success. Some departments will have greater say and will achieve their desired outcomes, whereas others will not. Researcher and scholar Charles Perrow surveyed managers in several industrial firms.[71] He bluntly asked, "Which department has the most power?" among four major departments: production, sales and marketing, R&D, and finance and accounting.

In most firms, sales had the greatest power. In a few firms, production was also quite powerful. On average, the sales and production-type departments were more powerful than Research & Development and HR, although substantial variation existed. Differences in the amount of horizontal power clearly occurred in those firms. Exhibit 14.7 illustrates the difference in power among several departments in a technology firm. In another recent study of 55 top-level decisions in 14 organizations in the United Kingdom, researchers found that production, finance, and marketing had the greatest influence on strategic decisions compared to R&D, HR, and purchasing.[72] Power shifts among departments depending on circumstances. Today, IT departments have gained power because of the digitalization of organizations, as discussed in

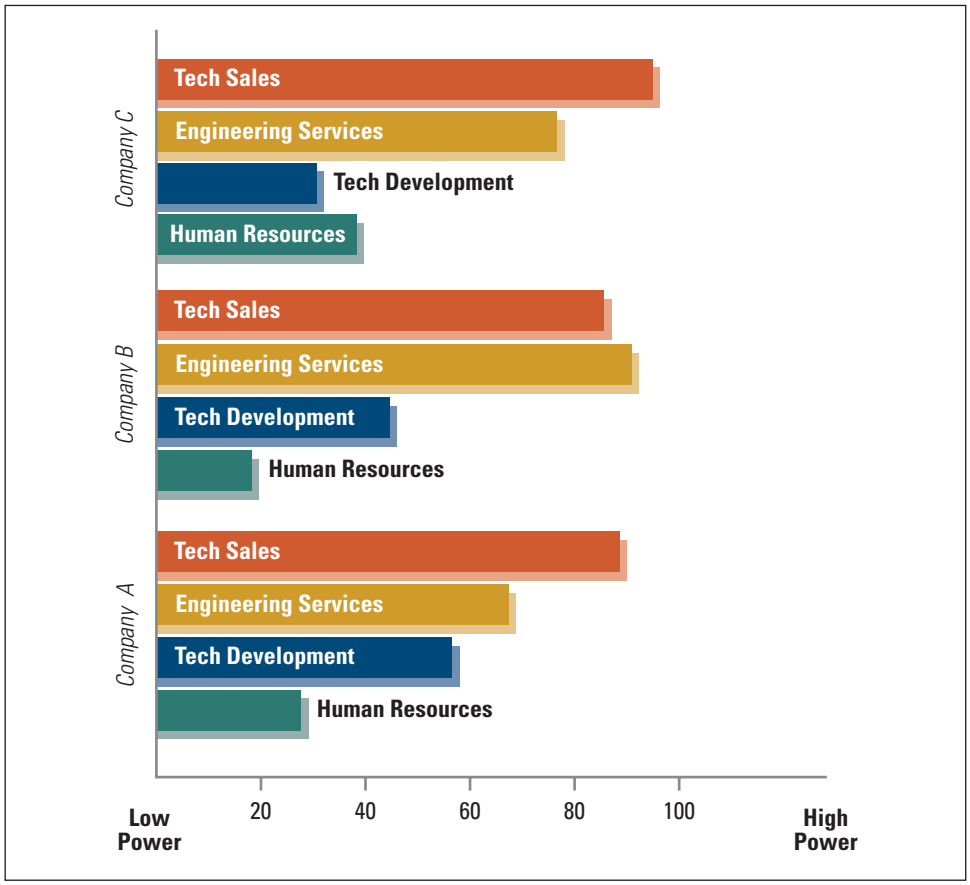

EXHIBIT 14.7
Ratings of Power Among Departments in a Technology Firm

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Chapter 9. Ethics and compliance offices may have greater power because they help reduce uncertainty for top leaders regarding ethical scandals and financial malfeasance.

Horizontal power is difficult to measure because power differences are not defined on the organization chart. However, some initial explanations for power differences, such as those shown in Exhibit 14.7, have been found. The theoretical concept that explains relative power is called strategic contingencies.[73]

Strategic Contingencies. **Strategic contingencies** are events and activities both inside and outside an organization that are essential for attaining organizational goals. Departments involved with strategic contingencies for the organization tend to have greater power. Departmental activities are important when they provide strategic value by solving problems or crises for the organization. For example, if an organization faces an intense threat from lawsuits and regulations, the legal department will gain power and influence over organizational decisions because it copes with such a threat. If product innovation is the key strategic issue, the power of R&D can be expected to be high.

The strategic contingencies approach to power is similar to the resource dependence model described in Chapters 4 and 5. Recall that organizations try to reduce dependence on the external environment. The strategic contingencies approach to power suggests that the departments or organizations most responsible for dealing with key resource issues and dependencies in the environment will become most powerful. In today's organizations, CIOs and IT departments are acquiring a tremendous amount of power as companies adapt to the new era of digital business. With digital technology at the heart of many organizations' strategies and business models, top executives are depending on CIOs to reduce uncertainty and help their companies harness the power of new technology tools. At Johnson & Johnson, where annual IT investment exceeds $2 billion a year, former CIO Stuart McGuigan said he interacted with the company's worldwide chairman six or seven times a day by text, e-mail, and phone, and the two frequently met face to face. Brian Cornell, CEO of retailer Target, said "I view technology today very differently than I did five or 10 years ago. It's no longer a backroom function." The interaction between Cornell and Target's CIO Mike McNamara "is constant" because IT runs through everything from store revamps to customer loyalty.[74]

Power Sources. Jeffrey Pfeffer and Gerald Salancik, among others, have been instrumental in conducting research on the strategic contingencies theory.[75] Their findings indicate that a department rated as powerful may possess one or more of the characteristics illustrated in Exhibit 14.8.[76] In some organizations, these five **power sources** overlap, but each provides a useful way to evaluate sources of horizontal power.

1. *Dependency.* Interdepartmental **dependency** is a key element underlying relative power. Power is derived from having something someone else wants. The power of theatrical stagehands provides an excellent example of how dependency increases power.

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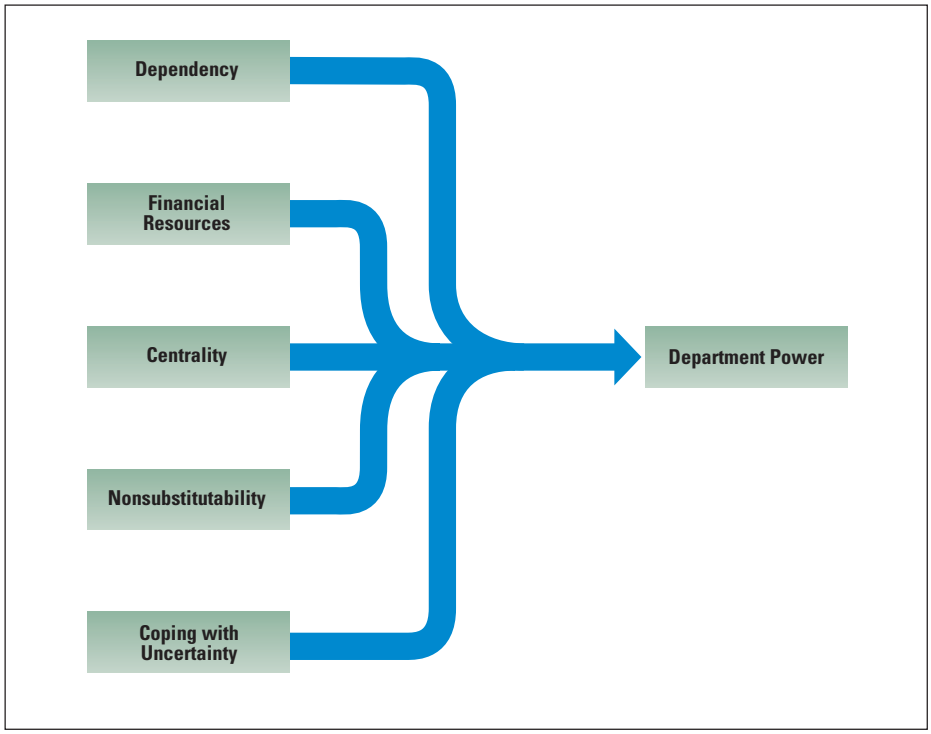

EXHIBIT 14.8
Strategic Contingencies that Influence Horizontal Power Among Departments

John Burke/Stockbyte/Getty Images

IN PRACTICE

International Alliance of Theatrical Stage Employees

The power of labor unions in the United States has weakened significantly in recent years, but not for the International Alliance of Theatrical Stage Employees, which has retained its clout and even grown stronger. For example, the 2,600 active members of Local 1 are the talent behind some of the most opulent performance sets in New York City, from Carnegie Hall to the Metropolitan Opera, to Lincoln Center, to the New York City Ballet. Stagehands for some performances earn more money than principal cast members.

The primary reason is that they have specialized, hard-to-replace skills. Good stagehands are not easy to find. They create the razzle-dazzle behind the Rockettes "Radio City Christmas Spectacular," raise the 45-foot Christmas tree for "George Balanchine's The Nutcracker," and are responsible for making the lavish ballroom set spin for the Metropolitan Opera's "Die Fledermaus." Bringing these dazzling stage effects to life requires talent, experience, and hard work. Unlike many tasks, the jobs of these highly skilled tradespeople cannot be easily outsourced. "Their jobs are extremely complex, extremely high-tech and possibly extremely dangerous," said Martha S. LoMonaco, a theater professor at Fairfield University.

If the stagehands walk out, the performance cannot go on. They set up and break down complicated sets, handle the lighting and sound equipment, and manage special effects. Even the threat of a strike can be enough for Local 1 to win favorable contract terms. There have been only a few strikes in the union's 127-year history. Like the theater owners and managers, the stagehands also understand that they only work when they have a show.[77]

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The same features of dependency and power can be seen in other organizations. The power of department A over department B is greater when department B depends on department A.[78] This is one source of increasing power for CIOs, as mentioned earlier, because almost every part of the organization depends on IT. Materials, information, and resources may flow between departments in one direction, such as in the case of sequential task interdependence (see Chapter 8). In such cases, the department receiving resources is in a lower power position than the department providing them. The number and strength of dependencies are also important. When seven or eight departments must come for help to the engineering department, for example, engineering is in a strong power position. In contrast, a department that depends on many other departments is in a low power position. Likewise, a department in an otherwise low power position might gain power through dependencies. If a factory cannot produce without the expertise of maintenance workers to keep the machines working, the maintenance department is in a strong power position because it has control over a strategic contingency.

2. *Financial resources.* Control over resources is an important source of power in organizations. Money can be converted into other kinds of resources that are needed by other departments. Money generates dependency; departments that provide financial resources have something other departments want. Departments that generate income for an organization have greater power. Exhibit 14.7 showed tech sales as the most powerful unit in most technology firms. This is because salespeople find customers and bring in money, thereby removing an important problem for the organization. An ability to provide financial resources also explains why certain departments are powerful in other organizations, such as universities.

   Budget allocation in a state university is not a straightforward process determined by such things as the number of undergraduate students, the number of graduate students, and the number of faculty in each department. In most universities, important resources come from research grants and the quality of students and faculty. Departments that generate large research grants are more powerful, for instance, because research grants contain a sizable overhead payment to university administration. This overhead money pays for a large share of the university's personnel and facilities. The size of a department's graduate student body and the national prestige of the department also add to power. Graduate students and national prestige are nonfinancial resources that add to the reputation and effectiveness of the university. How do university departments use their power? Generally, they use it to obtain even more resources from the rest of the university. Very powerful departments receive university resources, such as graduate student fellowships, internal research support, and summer faculty salaries, far in excess of their needs based on the number of students and faculty.[79]

   As shown by this example, power accrues to departments that bring in or provide resources that are highly valued by an organization. Power enables those departments to obtain more of the scarce resources allocated within the organization. "Power derived from acquiring resources is used to obtain more resources, which in turn can be employed to produce more power—the rich get richer."[80]

3. *Centrality.* **Centrality** reflects a department's role in the primary activity of an organization.[81] One measure of centrality is the extent to which the work of the department affects the final output of the organization. For example, the production department is more central and usually has more power than staff groups (assuming no other critical contingencies). Centrality is associated with power because it reflects the contribution made to the organization. The corporate finance department of an investment bank generally has more power than

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the stock research department. When the finance department has the limited task of recording money and expenditures, it tends to be low in power because it is not responsible for obtaining critical resources or for producing the products of the organization. Today, however, finance departments have greater power in many organizations because of the greater need for controlling costs.

4. *Nonsubstitutability.* Power is also determined by **nonsubstitutability**, which means that a department's function cannot be performed by other readily available resources, such as the stagehands described earlier. If an organization has no alternative sources of skill and information, a department's power will be greater. This can be one reason top managers use outside consultants. Consultants might be used as substitutes for staff people to reduce the power of staff groups.

   The impact of substitutability on power was studied for programmers in computer departments.[82] When computers were first introduced, programming was a rare and specialized occupation. Programmers controlled the use of organizational computers because they alone possessed the knowledge to program them. Over a period of about 10 years, computer programming became a more common activity. People could be substituted easily, and the power of programming departments dropped. Substitutability affects the power of organizations as well. Major record labels once had tremendous power over artists in the music industry because they had almost total control over which artists got their music recorded and in front of consumers. Today, though, new and established bands can release albums directly on the Internet without a traditional record company ever being involved.

5. *Coping with Uncertainty.* Elements in the environment can change swiftly and can be unpredictable and complex. In the face of uncertainty, little information is available to managers on appropriate courses of action. Departments that reduce this uncertainty for the organization will increase their power.[83] When market research personnel accurately predict changes in demand for new products, they gain power and prestige because they have reduced a critical uncertainty. But forecasting is only one technique. Sometimes uncertainty can be reduced by taking quick and appropriate action after an unpredictable event occurs.

   Departments can cope with critical uncertainties by (1) obtaining prior information, (2) prevention, and (3) absorption.[84] *Obtaining prior information* means a department can reduce an organization's uncertainty by forecasting an event. Departments increase their power through *prevention* by predicting and forestalling negative events. *Absorption* occurs when a department takes action after an event to reduce its negative consequences. With the increasing legal and regulatory challenges organizations face, in-house legal departments have grown in power. "Sometimes the [general counsel] will be paid more than the president of a business unit," says Cynthia Dow, an executive search consultant for Russell Reynolds Associates Inc.[85] Because hospitals and other healthcare providers have to deal with so many complex legal and regulatory matters, the legal department at Carilion Health System, based in Roanoke, Virginia, is in a high power position. Some years ago, the legal department successfully fought off a U.S. Department of Justice antitrust lawsuit and played a crucial role in negotiating a merger between Carilion and Roanoke's only other hospital. Since then, the legal department has been kept busy not only with regulatory issues but also with trying to get payment from patients who say they can't pay their high medical bills. During one recent fiscal year the legal department at Carilion sued nearly 10,000 patients, garnished the wages of more than 5,000 people, and placed liens on nearly 4,000 homes. The legal department is central to reducing uncertainty about revenue.[86]

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BRIEFCASE

As an organization manager, keep these guidelines in mind:

Be aware of the important horizontal power relationships that come from the ability of a department to deal with strategic contingencies that confront the organization. Increase the horizontal power of a department by increasing involvement in strategic contingencies.

Horizontal power relationships in organizations change as strategic contingencies change. Whereas the legal department will likely continue in a high power position at Carilion, the need of the hospital to improve its reputation and fend off growing criticism could lead to an increase in the power of the public relations department. The public relations department can gain power by being involved in activities targeted toward both prevention and absorption. Departments that help organizations cope with new strategic issues will increase their power.

REMEMBER THIS

- Hard power includes legitimate power, reward power, and coercive power. Two types of soft power are expert power and referent power. Individuals in organizations may use each of these sources of power, but power in organizations is also the result of structural characteristics.
- Vertical sources of power include formal position, resources, control of information, and network centrality. In general, managers at the top of the organizational hierarchy have more power than people at lower levels.
- Many top executives believe that increasing the power of middle managers and lower-level employees can help the organization be more competitive. Empowerment is a popular trend. Empowering employees means giving them three key elements: information and resources, necessary knowledge and skills, and the power to make substantive decisions.
- Research into horizontal power processes has revealed that certain characteristics make some departments more powerful than others. Differences in power can be understood using the concept of strategic contingencies. Departments responsible for dealing with key resource issues and dependencies are more powerful. Such factors as dependency, resources, nonsubstitutability, and dealing with uncertainty determine the power of departments.

14.3 Political Processes in Organizations

Politics, like power, is intangible and difficult to measure. It is hidden from view and is hard to observe in a systematic way. Two surveys uncovered the following reactions of managers toward political behavior.[87]

1. Most managers have a negative view toward politics and believe that politics will more often hurt than help an organization in achieving its goals.
2. Managers believe that political behavior is common in practically all organizations.
3. Most managers think that political behavior occurs more often at upper rather than lower levels in organizations.
4. Managers believe political behavior arises in certain decision domains, such as structural change, but is absent from other decisions, such as handling employee grievances.

Based on these surveys, politics seems more likely to occur at the top levels of an organization and around certain issues and decisions. Moreover, managers do not

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approve of political behavior. The remainder of this chapter explores more fully what political behavior is, when it should be used, the type of issues and decisions most likely to be associated with politics, and some political tactics that may be effective.

14.3a Definition

Power has been described as the available force or potential for achieving desired outcomes. *Politics* is the use of power to influence decisions in order to achieve those outcomes. The exercise of power to influence others has led to two ways to define politics: as self-serving behavior or as a natural organizational decision process. The first definition emphasizes that politics is self-serving and involves activities that are not sanctioned by the organization.[88]

In this view, politics involves deception and dishonesty for purposes of individual self-interest and leads to conflict and disharmony within the work environment. This dark view of politics is widely held by laypeople, and political activity certainly can be used in this way. Studies have shown that workers who perceive this kind of political activity within their companies often have related feelings of anxiety and job dissatisfaction. Research also supports the belief that an inappropriate use of politics is related to low employee morale, inferior organizational performance, and poor decision making.[89] This view of politics explains why managers in the aforementioned surveys did not approve of political behavior.

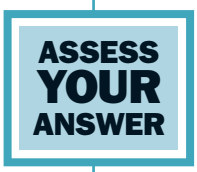
Although politics can be used in a negative, self-serving way, the appropriate use of political behavior can serve organizational goals.[90] The second view sees politics as a natural organizational process for resolving differences among organizational interest groups.[91] Politics is the process of bargaining and negotiation that is used to overcome conflicts and differences of opinion. In this view, politics is similar to the coalition-building decision processes described in Chapter 13.

The organization theory perspective views politics as described in the second definition. Politics is simply the activity through which power is exercised in the resolution of conflicts and uncertainty. Politics is neutral and is not necessarily harmful to the organization. The formal definition of organizational politics is as follows: **organizational politics** involves activities to acquire, develop, and use power and other resources to influence others and obtain the preferred outcome when there is uncertainty or disagreement about choices.[92]

Political behavior can be either a positive or a negative force. Politics is the use of power to get things accomplished—good things as well as bad. Uncertainty and conflict are natural and inevitable, and politics is the mechanism for reaching agreement. Politics includes informal discussions that enable people to arrive at consensus and make decisions that otherwise might be stalemated or unsolvable.

3 **When managers use politics, it usually leads to conflict and disharmony and will likely disrupt the smooth functioning of the organization.**

ANSWER: *Disagree.* Politics is a natural organizational process for resolving differences and getting things done. Although politics can be used for negative and self-serving purposes, political activity is also the primary way managers are brought together to accomplish good things. Being political is part of the job of a manager, but managers should take care to use politics to serve the interests of the organization rather than themselves.



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14.3b When to Use Political Activity

Politics is a mechanism for arriving at consensus when uncertainty is high and there is disagreement over goals or problem priorities. Recall the rational versus political models described in Exhibit 14.2. The political model is associated with conflict over goals, shifting coalitions and interest groups, ambiguous information, and uncertainty. Thus, political activity tends to be most visible when managers confront nonprogrammed decisions, as described in Chapter 13, and is related to the Carnegie model of decision making. Because managers at the top of an organization generally deal with more nonprogrammed decisions than do managers at lower levels, more political activity will appear at higher levels. Moreover, some issues are associated with inherent disagreement. Resources, for example, are critical for the survival and effectiveness of departments, so resource allocation often becomes a political issue. Rational methods of allocation do not satisfy participants. Three **domains of political activity** (areas in which politics plays a role) in most organizations are structural change, management succession, and resource allocation.

Structural reorganizations strike at the heart of power and authority relationships. Reorganizations such as those discussed in Chapter 3 change responsibilities and tasks, which also affects the underlying power base from strategic contingencies. For these reasons, a major reorganization can lead to an explosion of political activity.[93]

Managers may actively bargain and negotiate to maintain the responsibilities and power bases they have. Mergers and acquisitions also frequently create tremendous political activity. Consider the political actions that occurred when executives at Japan's Nissan feared further corporate integration of their company with French automaker Renault.

IN PRACTICE

Nissan and Renault

Carlos Ghosn was once a titan of the auto industry, but today the former head of Renault Nissan sits in jail. He ended up there partly because some Nissan executives wanted to derail plans for a full combination of Nissan and Renault, which is 15 percent owned by the French government. The two companies first entered a partnership in a 1999 bailout deal by Renault when Nissan was struggling. The deal gave Renault 43.4 percent of Nissan, while Nissan holds only a 15 percent nonvoting stake in Renault. Ghosn became a hero for his successful turnaround of Nissan. He served as CEO of both Nissan and Renault for more than a decade and had always been a supporter of autonomy for each company. However, when his contract as Renault chairman and CEO came up for renewal, Ghosn agreed to a modest salary cut and a commitment to "take decisive steps to make the alliance irreversible," according to a Renault press release. The French government had been pressing for a full merger for some time and Ghosn needed the government's support for his continued leadership.

When the French government announced it would like the two companies to merge, and Ghosn began pushing for it to happen quickly, two Nissan executives swung into action behind the scenes. They wanted to ensure that Nissan did not lose autonomy as a famous Japanese company. The executives launched an investigation of Ghosn until they found evidence of financial impropriety and handed it over to Japanese prosecutors. Ghosn ended up in jail, stripped of his titles at Renault and Nissan, and the merger discussions were back to square one, which was the desired outcome.

Ghosn denies any wrongdoing and says Nissan executives were "playing a very dirty game," stabbing him in the back because the next step of the alliance would threaten their jobs. Nissan, however, emphasizes that Ghosn's own actions led to his arrest. "Aside from any criminal matters, Nissan's internal investigation has uncovered substantial evidence of blatantly unethical conduct," said a spokesman.[94]

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Although this is an extreme example, it illustrates the political dynamics that frequently occur surrounding issues such as mergers, acquisitions, or major structural reorganizations. Organizational changes such as hiring new executives, promotions, and transfers also have great political significance, particularly at top organizational levels where uncertainty is high and networks of trust, cooperation, and communication among executives are important.[95] Hiring decisions can generate uncertainty, discussion, and disagreement. Managers can use hiring and promotion to strengthen network alliances and coalitions by putting their own people in prominent positions.

The third area of political activity is resource allocation. Resource-allocation decisions encompass all resources required for organizational performance, including salaries, operating budgets, employees, office facilities, and equipment. Resources are so vital that disagreement about priorities exists, and political processes help resolve the dilemmas.

REMEMBER THIS

- In organizations, politics involves activities to acquire, develop, and use power and other resources to influence others when there is uncertainty or disagreement about choices.
- Many people distrust political behavior, fearing that it will be used for selfish ends that benefit the individual but not the organization. However, politics is often needed to achieve the legitimate goals of a department or organization. Political behavior can be either a positive or a negative force and managers should take care to use politics appropriately.
- Three areas in which political behavior often plays a role are structural change, management succession, and resource allocation because these are areas of high uncertainty.

14.4 Using Soft Power and Politics

One theme in this chapter has been that power in organizations is not primarily a phenomenon of the individual. It is related to the resources departments command, the role departments play in an organization, and the environmental contingencies with which departments cope. Position and responsibility, more than personality and style, may determine a manager's ability to influence outcomes in the organization.

However, power is used through individual political behavior. To fully understand the use of power within organizations, it is important to look at both structural components and individual behavior.[96] Although power often comes from larger organizational forms and processes, the political use of power involves individual-level activities and skills. To learn about your political skills, complete the questionnaire in the "How Do You Fit the Design?" box. Managers with political skill are more effective at influencing others and thus getting what they want, for the organization and for their own careers.[97] These managers have honed their abilities to observe and understand patterns of interaction and influence in the organization.

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They are skilled at developing relationships with a broad network of people and can adapt their behavior and approach to diverse people and situations. Politically effective managers understand that influence is about relationships.[98]

Managers can develop political competence, and they can learn to use a wide variety of influence tactics depending on their own position as well as the specific situation. Some tactics rely on the use of hard power, which is power that stems largely from a person's position of authority, as described earlier in this chapter. This is the kind of power that enables a supervisor to influence subordinates with the use of rewards and punishments, allows a manager to issue orders and expect them to be obeyed, or lets a domineering CEO force through his or her own decisions without regard for what anyone else thinks. However, effective managers more often use soft power, which is based on personal characteristics and relationships.[99] Jeff Immelt, former CEO of General Electric, once said he considered himself a failure if he exercised his formal authority more than seven or eight times a year at GE. The rest of the time, Immelt used softer means to persuade and influence others and to resolve conflicting ideas and opinions.[100]

HOW DO YOU FIT THE DESIGN?

POLITICAL SKILLS

How good are you at influencing people across an organization? To learn something about your political skills, answer the questions that follow. Please answer whether each item is Mostly True or Mostly False for you.

	Mostly True	Mostly False
1. I am able to communicate easily and effectively with others.	_____	_____
2. I spend a lot of time at work developing connections with people outside my area.	_____	_____
3. I instinctively know the right thing to say or do to influence others.	_____	_____
4. I am good at using my connections outside my area to get things done at work.	_____	_____
5. When communicating with others, I am absolutely genuine in what I say and do.	_____	_____
6. It is easy for me to reach out to new people.	_____	_____
7. I make strangers feel comfortable and at ease around me.	_____	_____
8. I am good at sensing the motivations and hidden agendas of others.	_____	_____

Scoring: Give yourself one point for each item marked as Mostly True.

Interpretation: Having some basic political skill helps a manager gain broad support and influence. Political skills help a manager build personal and organizational relationships that enhance your team's outcomes. A score of 6 or higher suggests active political skills and a good start for your career, especially in an organization in which things get done politically. If you scored 3 or less, you may want to focus more on building collegial and supportive relationships as you progress in your career. If not, perhaps join an organization in which decisions and actions are undertaken by rational procedures rather than by support of key coalitions.

Source: Adapted from Gerald R. Ferris, Darren C. Treadway, Robert W. Kolodinsky, Wayne A. Hochwarter, Charles J. Kacmer, Ceasar Douglas, and Dwight D. Frink, "Development and Validation of the Political Skill Inventory," *Journal of Management* 31 (February 2005), 126–152.

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Tactics for Increasing the Power Base	Political Tactics for Using Power
1. Enter areas of high uncertainty.	1. Build coalitions and expand networks.
2. Create dependencies.	2. Assign loyal people to key positions.
3. Provide scarce resources.	3. Control decision premises.
4. Satisfy strategic contingencies.	4. Enhance legitimacy and expertise.
	5. Make a direct appeal.
	6. Create a higher purpose.

EXHIBIT 14.9
Power and Political Tactics in Organizations

Even the U.S. military is talking about the importance of building relationships rather than using brute force. The U.S. Army's stability operations field manual openly talks about the value of soft power.[101] Wesley Clark, former supreme commander of NATO who led the mission against Serb president Slobodan Milosevic, suggests that, for leaders in businesses as well as nations, building a community of shared interests should be the first choice, rather than using threats, intimidation, and raw power.[102] The effectiveness of soft power is revealed in a study of 49 professional negotiators over a nine-year period of time. Researchers found that the most effective negotiators spent 400 percent more time than their less-effective counterparts looking for areas of mutual benefit and shared interest, rather than just trying to force their own agenda.[103]

The following sections summarize various tactics that managers can use to increase their own or their department's power base, and the political tactics they can use to achieve desired outcomes. Most of these tactics, summarized in Exhibit 14.9, rely on the use of soft rather than hard power.

14.4a Tactics for Increasing Power

Four **tactics for increasing power** are as follows:

1. *Enter areas of high uncertainty.* One source of individual or departmental power is to identify key uncertainties and take steps to remove those uncertainties.[104] Uncertainties could arise from stoppages on an assembly line, from the quality demanded of a new product, or from the inability to predict a demand for new services. Once an uncertainty is identified, the department can take action to cope with it. By their very nature, uncertain tasks will not be solved immediately. Trial and error will be needed, which is to the advantage of the department. The trial-and-error process provides experience and expertise that cannot easily be duplicated by other departments.
2. *Create dependencies.* Dependencies are another source of power.[105] When the organization depends on a department or individual for information, materials, knowledge, or skills, that department or individual will hold power over others. A somewhat amusing example comes from Evan Steingart's consumer products company. A low-level inventory-transfer clerk in the shipping department had to sign off on the shipment of all goods. Salespeople were dependent on the clerk for his signature. Those who wanted their orders shipped quickly learned to cozy up to the clerk. Arrogant ones who treated him badly would find themselves at a disadvantage, as the clerk would have a long list of things to do before he could get to their shipping order, and the salespeople had no recourse but to wait.[106] An equally effective and related strategy is to reduce dependency on other departments by acquiring necessary information or skills when possible, so that your department isn't in a dependent position. For example, the sales

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manager might seek signing authority to eliminate salespeople's dependence on the inventory clerk and the shipping department.

3. *Provide scarce resources*. Resources are always important to organizational survival. Departments that accumulate resources and provide them to an organization in the form of money, information, or facilities will be powerful. An earlier example described how university departments with the greatest power are those that obtain external research funds for contributions to university overhead. Likewise, sales departments are powerful in most firms because they bring in financial resources.
4. *Satisfy strategic contingencies*. The theory of strategic contingencies says that some elements in the external environment and within the organization are especially important for organizational success. A contingency could be a critical event, a task for which there are no substitutes, or a central task that is interdependent with many others in the organization. An analysis of the organization and its changing environment will reveal strategic contingencies. To the extent that contingencies are new or are not being satisfied, there is room for a department to move into those critical areas and increase its importance and power.

In summary, the allocation of power in an organization is not random. Power is the result of organizational processes that can be understood and predicted. The abilities to reduce uncertainty, increase dependency on one's own department, obtain resources, and cope with strategic contingencies all enhance a department's power. Once power is available, the next challenge is to use it to attain desired outcomes.

14.4b Political Tactics for Using Power

The use of power in organizations requires both skill and willingness. Many decisions are made through political processes because rational decision processes do not fit. Uncertainty or disagreement is too high. **Political tactics for using power** to influence decision outcomes include the following:

1. *Build coalitions and expand networks*. Effective managers develop positive relationships throughout the organization, and they spend time talking with others to learn about their views and build mutually beneficial alliances and coalitions.[107] Most important decisions are made outside of formal meetings. Managers discuss issues with each other and reach agreement. Effective managers are those who huddle, meeting in groups of twos and threes to resolve key issues.[108] They also make sure their networks cross hierarchical, functional, and even organizational boundaries. One research project found that the ability to build networks has a positive impact on both employees' perception of a manager's effectiveness and the ability of the manager to influence performance.[109] Networks can be expanded by (1) reaching out to establish contact with additional managers and (2) co-opting dissenters. Establishing contact with additional managers means building good interpersonal relationships based on liking, trust, and respect. Reliability and the motivation to work with rather than exploit others are part of both networking and coalition building.[110] The second approach to expanding networks, cooptation, is the act of bringing a dissenter into one's network. One example of cooptation involved a university committee whose membership was based on promotion and tenure. Several professors who were critical of the tenure and promotion process were appointed to the committee. Once a part of the administrative process, they could see the administrative point of view. Cooptation effectively brought them into the administrative network.[111]

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2. *Assign loyal people to key positions.* Another political tactic is to assign trusted and loyal people to key positions in the organization or department. For example, even after he resigned as CEO of Uber, Travis Kalanick exercised his voting rights as a board member to add people to the board that he believed would help him regain control of the company.[112] Top managers as well as department heads often use the hiring, transfer, and promotion processes to place in key positions people who are sympathetic to the outcomes of the department, thus helping to achieve departmental goals.[113] Top leaders frequently use this tactic, as we discussed earlier. Look at what is happening with Pope Francis at the Vatican.

IN PRACTICE

The Vatican

Less than a year into his papacy, Pope Francis had significantly reshaped the way the Catholic Church is run by changing who is running it. Francis has been steadily bringing his own people to positions of power to help him achieve his goal of creating a more inclusive and relevant church for this century.

Conservative cardinals such as Raymond L. Burke, one of the highest-ranking Americans at the Vatican, who had tremendous influence in selecting new bishops in the United States, and Mauro Piacenza, who ran the powerful Congregation for the Clergy, have been demoted or had their power diluted. Francis is replacing these traditionalists put in place by his predecessor with more moderate leaders who are in tune with his mission for transforming the church. Guido Pozzo, another conservative who was elevated to the rank of archbishop and appointed to run the church's charity office by Benedict, has also been sent back to his former post by Francis.

Similar changes are going on in other areas. Shortly before he resigned, Benedict approved new five-year terms for the existing five-man committee that oversees the Vatican Bank. Francis has replaced all but one of those committee members with his own picks. He also appointed a separate special commission to examine the bank's activities and improve control and oversight. "It's a strong signal of change in the management of the pontifical finances," said journalist Carlo Marroni, an expert on Vatican financial affairs.[114]

Like other top leaders, Pope Francis is using the hiring, promotion, and transfer processes to put loyal and trusted people in positions where they can help him achieve his mission and goals for the organization.

3. *Use reciprocity.* There is much research indicating that most people feel a sense of obligation to give something back in return for favors others do for them.[115] This *principle of reciprocity* is one of the key factors affecting influence relationships in organizations. When a manager does a favor for a colleague, the colleague feels obliged to return the favor in the future. "We're given serious persuasive powers immediately after someone thanks us," says Robert Cialdini, a leading social scientist in the field of influence. Cialdini says managers should take advantage of that to remind others that it's a reciprocal relationship by saying something like, "Of course, it's what partners do for each other."[116] The "unwritten rule of reciprocity" is one reason organizations like Northrop Grumman, Kraft Heinz, and Pfizer make donations to the favorite charities of House and Senate members. Leaders attempt to curry favor with lawmakers whose decisions can significantly affect their business.[117] As with other political tactics, managers sometimes use reciprocity for self-serving purposes that can harm the organization and its stakeholders. For instance, investigators have questioned whether a "culture of complicity" that involves nuclear industry officials, power company managers, politicians, and regulators doing favors for one another played a role in the accident at the Fukushima Daiichi power plant.[118]

The pattern of favors revealed by investigations into Japan's nuclear industry reflects the significant role reciprocity plays in influence relationships. Some

BRIEFCASE

As an organization manager, keep these guidelines in mind:

Expect and allow for political behavior in organizations. Politics provides the discussion and clash of interests needed to crystallize points of view and to reach a decision. Build coalitions, expand networks, use reciprocity, enhance legitimacy, and make a direct appeal to attain desired outcomes.

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researchers argue that the concept of exchange—trading something of value for what you want—is the basis of all other influence tactics. For example, rational persuasion works because the other person sees a benefit from going along with the plan, and making people like you is successful because the other person receives liking and attention in return.[119] This chapter's BookMark further discusses reciprocity and other basic influence principles.

4. *Enhance legitimacy and expertise.* Managers can exert the greatest influence in areas in which they have recognized legitimacy and expertise. This tactic is highly effective with the younger generation of managers and employees. Today's young workers define power based on an individual's knowledge and skills rather than a position of authority over people. Indeed, many people don't appreciate the strong use of politics and expect people to rely on their knowledge and credibility to influence others.[120] When managers make a request that is within the task

BOOKMARK 14.0 HAVE YOU READ THIS BOOK?

Influence: Science and Practice

By Robert B. Cialdini

Managers use a variety of political tactics to influence others and bring about desired outcomes. In his book *Influence: Science and Practice*, Robert Cialdini examines the social and psychological pressures that cause people to respond favorably to these various tactics. Over years of study, Cialdini, Regents' Professor Emeritus of Psychology and Marketing at Arizona State University, has identified some basic *influence principles,* "those that work in a variety of situations, for a variety of practitioners, on a variety of topics, for a variety of prospects."

INFLUENCE PRINCIPLES

Having a working knowledge of the basic set of persuasion tools can help managers predict and influence human behavior, which is valuable for interacting with colleagues, employees, customers, partners, and even friends. Some basic psychological principles that govern successful influence tactics are as follows:

- *Reciprocity.* The principle of reciprocity refers to the sense of obligation people feel to give back in kind what they have received. For example, a manager who does favors for others creates in them a sense of obligation to return the favors in the future. Smart managers find ways to be helpful to others, whether it be helping a colleague finish an unpleasant job or offering compassion and concern for a subordinate's personal problems.
- *Liking.* People say *yes* more often to those they like. Companies such as Tupperware or Pampered Chef have long understood that familiar faces and congenial characteristics sell products. In-home parties allow customers to buy from a friend instead of an unknown salesperson. Salespeople in all kinds of companies often try to capitalize on this principle by finding interests they share with customers as a way to establish rapport. In general, managers who are pleasant, generous with praise, cooperative, and considerate of others' feelings find that they have greater influence.
- *Credible authority.* Legitimate authorities are particularly influential sources. However, research has discovered that the key to successful use of authority is to be knowledgeable, credible, and trustworthy. Managers who become known for their expertise, who are honest and straightforward with others, and who inspire trust can exert greater influence than those who rely on formal position alone.
- *Social validation.* One of the primary ways people decide what to do in any given situation is to consider what others are doing. That is, people examine the actions of others to validate correct choices. For instance, when homeowners were shown a list of neighbors who had donated to a local charity during a fundraiser, the frequency of contributions increased dramatically. By demonstrating, or even implying, that others have already complied with a request, managers gain greater cooperation.

THE PROCESS OF SOCIAL INFLUENCE

Because life as a manager is all about influencing others, learning to be genuinely persuasive is a valuable management skill. Cialdini's book helps managers understand the basic psychological rules of persuasion—how and why people are motivated to change their attitudes and behaviors. When managers use this understanding in an honest and ethical manner, they improve their effectiveness and the success of their organizations.

Influence: Science and Practice (4th edition), by Robert B. Cialdini, is published by Allyn & Bacon.

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domain of a department and is consistent with the department's vested interest, other departments will tend to comply. Members can also identify external consultants or other experts within the organization to support their cause.[121]

5. *Make a direct appeal.* If managers do not ask, they seldom receive. An example of direct appeal comes from Drugstore.com, where Jessica Morrison used direct appeal to get a new title and a salary increase. Morrison researched pay scales on PayScale.com and approached her boss armed with that and other pertinent information. Her direct appeal, backed up with research, won her the promotion.[122] Political activity is effective only when goals and needs are made explicit so the organization can respond. An assertive proposal may be accepted because other managers have no better alternatives. Moreover, an explicit proposal will often receive favorable treatment because other alternatives are ambiguous and less well defined. Effective political behavior requires sufficient forcefulness and risk-taking to at least ask for what you need to achieve desired outcomes.
6. *Create a higher purpose.* Recall our discussion from earlier in this chapter about the importance of a shared mission and superordinate goals for getting people to cooperate across departments. A superordinate goal is a higher goal that gets people from opposing sides to come together and work toward a common end result. In a crisis such as a flood or tornado, even people who vehemently dislike one another will often work together to save lives and restore their community. When people have a higher purpose for their work, they are more willing to put their differences aside. Managers can use the idea of superordinate goals to accomplish desired results by creating a vision or mission that inspires people. Consider the building of the Beijing National Aquatics Center (typically called the "Water Cube"), which was constructed for the 2008 Summer Olympics and will host the curling events during the 2022 Winter Olympics. When designing the Aquatics Center, two architectural firms—one Chinese and the other Australian—developed designs that were totally different. This created tensions between the two groups, but the larger vision of creating a spectacular building that the whole world would admire inspired them to work together rather than continuing to fight for their own ideas. The two sides eventually came up with a totally new concept that excited everyone.[123]

Managers can use an understanding of these tactics to assert influence and get things done within the organization. When managers ignore soft power and political tactics, they may find themselves failing without understanding why. For example, at the World Bank, Paul Wolfowitz tried to wield hard power without building the necessary relationships he needed to assert influence.

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IN PRACTICE
World Bank

After former deputy secretary of defense Paul Wolfowitz lost his bids to become defense secretary or national security advisor in the Bush administration, he jumped at the chance to be the new president of World Bank. But Wolfowitz doomed his career at World Bank from the start by failing to develop relationships and build alliances.

Most World Bank leaders had been in their positions for many years when

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Wolfowitz arrived, and they were accustomed to "promoting each other's interests and scratching each other's backs," as one board member put it. Wolfowitz came in and tried to assert his own ideas, goals, and formal authority without considering the interests, ideas, and goals of others. He quickly alienated much of the World Bank leadership team and board by adopting a single-minded position on key issues and refusing to consider alternative views. Rather than attempting to persuade others to his way of thinking, Wolfowitz issued directives to senior bank officers, either personally or through his handpicked managers. Several high-level officers resigned following disputes with the new president.

Eventually, the board asked for Wolfowitz's resignation. "What Paul didn't understand is that the World Bank presidency is not inherently a powerful job," said one former colleague. "A bank president is successful only if he can form alliances with the bank's many fiefdoms. Wolfowitz didn't ally with those fiefdoms. He alienated them."[124]

Wolfowitz realized too late that he needed to use a political, soft-power approach rather than trying to force his own agenda. Even when a manager has a great deal of power, the use of power should not be obvious.[125] If a manager formally draws on her power base in a meeting by saying, "My department has more power, so the rest of you have to do it my way," her power will be diminished. Power works best when it is used quietly. To call attention to power is to lose it. People know who has power. Explicit claims to power are not necessary and can even harm the manager's or department's cause.

Also, when using any of the preceding tactics, recall that most people think self-serving behavior hurts rather than helps an organization. If managers are perceived to be throwing their weight around or pursuing goals that are self-serving rather than beneficial to the organization, they will lose respect. On the other hand, managers must recognize the relational and political aspect of their work. It is not sufficient to be rational and technically competent. Developing and using political skills is an important part of being a good manager.

REMEMBER THIS

- Managers need political skills to exercise soft as well as hard power. Those who ignore soft power and political tactics may find themselves failing without understanding why.
- Tactics for increasing power include entering areas of high uncertainty, creating dependencies, providing scarce resources, and satisfying strategic contingencies.
- Political tactics for using power include building coalitions and expanding networks, assigning loyal people to key positions, using reciprocity, enhancing legitimacy, making a direct appeal, and creating a higher purpose and superordinate goals. Managers can use these tactics to help their departments achieve desired outcomes.

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KEY CONCEPTS

authority
centrality
collective bargaining
competition
confrontation
dependency
domains of political activity
empowerment
intergroup conflict
labor-management teams
negotiation
network centrality
nonsubstitutability
organizational politics
political model
political tactics for using power
power
power sources
rational model
sources of intergroup conflict
strategic contingencies
tactics for enhancing collaboration
tactics for increasing power

DISCUSSION QUESTIONS

1. Give an example from your personal experience of how differences in tasks, personal background, and training lead to conflict among groups. How might task interdependence have influenced that conflict?
2. Starbucks and Barnes & Noble entered into a partnership that places a Starbucks in each B&N bookstore. What organizational and environmental factors might determine which organization will have more power in the relationship?
3. In a rapidly changing organization, are decisions more likely to be made using the rational or political model of organization? Discuss.
4. What is the difference between power and authority? Is it possible for a person to have formal authority but no real power? Discuss.
5. Discuss ways in which a department at a health insurance company might help the organization cope with the increased power of large hospital systems such as Carilion by obtaining prior information, prevention, or absorption.
6. State University X receives 90 percent of its financial resources from the state and, because tuition is cheap, is overcrowded with students. The admissions office is overwhelmed with applications, and the university is trying to pass regulations to limit student enrollment. Private University Y receives 90 percent of its income from student tuition and has barely enough students to make ends meet. The admissions office is actively recruiting students for next year. Using the strategic contingencies notion of power, in which university will the admissions office have greater power? What implications will this have for professors and administrators? Discuss.
7. A financial analyst at Merrill Lynch tried for several months to expose the risks of investments in subprime mortgages, but he couldn't get anyone to pay attention to his claims. How would you evaluate this employee's power? What might he have done to increase his power and call notice to the impending problems at the firm?
8. The engineering college at a major university brings in three times as many government research dollars as does the rest of the university combined. Engineering appears wealthy and has many professors on full-time research status. Yet, when internal research funds are allocated, engineering gets a larger share of the money, even though it already has substantial external research funds. Why would this happen?
9. Some researchers argue that the concept of exchange underlying the principle of reciprocity (trading something of value to another for what you want) is the basis of *all* influence. Do you agree? Discuss. To what extent do you feel obligated to return a favor that is done for you?

CHAPTER 14 WORKSHOP How Do You Handle Conflict?

Think about how you typically handle a dispute with a team member, friend, or co-worker and then answer the following statements based on whether they are True or False for you. There are no right or wrong answers, so answer honestly.

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	Mostly True	Mostly False
1. I feel that differences are not worth arguing about.	_____	_____
2. I would avoid a person who wants to discuss a disagreement.	_____	_____
3. I would rather keep my views to myself than argue.	_____	_____
4. I typically avoid taking positions that create a dispute.	_____	_____
5. I try hard to win my position.	_____	_____
6. I strongly assert my opinion in a disagreement.	_____	_____
7. I raise my voice to get other people to accept my position.	_____	_____
8. I stand firm in expressing my viewpoint.	_____	_____
9. I give in a little if other people do the same.	_____	_____
10. I will split the difference to reach an agreement.	_____	_____
11. I offer tradeoffs to reach a solution.	_____	_____
12. I give up some points in exchange for others.	_____	_____
13. I don't want to hurt others' feelings.	_____	_____
14. I am quick to agree when someone I am arguing with makes a good point.	_____	_____
15. I try to smooth over disagreements by minimizing their seriousness.	_____	_____
16. I want to be considerate of other people's emotions.	_____	_____
17. I suggest a solution that includes the other person's point of view.	_____	_____
18. I combine arguments into a new solution from ideas raised in the dispute.	_____	_____
19. I try to include the other person's ideas to create a solution they will accept.	_____	_____
20. I assess the merits of other viewpoints as equal to my own.	_____	_____

Scoring and Interpretation:

Five categories of conflict-handling strategies are measured by these 20 questions: avoiding, dominating, bargaining, accommodating, and collaborating. These five strategies reflect different levels of personal desire for *assertiveness* or *cooperation*. The higher your score for a strategy, the more likely that is your preferred conflict-handling approach. A lower score suggests you probably do not use that approach.

Dominating Style (my way) reflects a high degree of assertiveness to get one's own way and fulfill one's self-interest. Sum one point for each Mostly True for items 5–8: _____.

Accommodating Style (your way) reflects a high degree of cooperativeness and a desire to oblige or help others as most important. Sum one point for each Mostly True for items 13–16: _____.

Avoiding Style (no way) reflects neither assertiveness nor cooperativeness, which means that conflict is avoided whenever possible. Sum one point for each Mostly True for items 1–4: _____.

Bargaining Style (half way) reflects a tendency to meet halfway by using a moderate amount of both assertiveness and cooperativeness. Sum one point for each Mostly True for items 9–12: _____.

Collaborating Style (our way) reflects a high degree of both assertiveness and cooperativeness to meet the needs of both parties. Sum one point for each Mostly True for items 17–20: _____.

Questions

1. Divide into small groups of 3–4 students. Which strategy does each group member find easiest to use? Most difficult?
2. How would each person's answers change if the other party to the conflict was a friend, family member, or co-worker?
3. Each person share how you feel about your approach to handling conflict. What changes would you like to make?

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CASE FOR ANALYSIS | East Tennessee News[126]

The *Daily Tribune* is the only daily newspaper serving a six-county region of eastern Tennessee. Even though its staff is small and it serves a region of mostly small towns and rural areas, the *Tribune* has won numerous awards for news coverage and photojournalism from the Tennessee Press Association and other organizations.

Rick Arnold became news editor almost 20 years ago. He has spent his entire career with the *Tribune* and feels a great sense of pride that it has been recognized for its journalistic integrity and balanced coverage of issues and events. The paper has been able to attract bright, talented young writers and photographers, thanks largely to Rick's commitment and his support of the news staff. In his early years, the newsroom was a dynamic, exciting place to work—reporters thrived on the fast pace and the chance to occasionally scoop the major daily paper in Knoxville.

But times have changed at the *Daily Tribune*. Over the past five years or so, the advertising department has continued to grow, in terms of both staff and budget, while the news department has begun to shrink. "Advertising pays the bills," publisher John Freeman reminded everyone at this month's managers' meeting. "Today, advertisers can go to direct mail, cable television, even the Internet, if they don't like what we're doing for them."

Rick has regularly clashed with the advertising department regarding news stories that are critical of major advertisers, but the conflicts have increased dramatically over the past few years. Now, Freeman is encouraging greater "horizontal collaboration," as he calls it, asking that managers in the news department and the ad department consult with one another regarding issues or stories that involve the paper's major advertisers. The move was prompted in part by a growing number of complaints from advertisers about stories they deemed unfair. "We print the news," Freeman said, "and I understand that sometimes we've got to print things that some people won't like. But we've got to find ways to be more advertiser-friendly. If we work together, we can develop strategies that both present good news coverage and serve to attract more advertisers."

Rick left the meeting fuming, and he didn't fail to make his contempt for the new "advertiser-friendly" approach known to all, including the advertising manager, Fred Thomas, as he headed down the hallway back to the newsroom. Lisa Lawrence, his managing editor, quietly agreed but pointed out that advertisers were readers too, and the newspaper had to listen to all its constituencies. "If we don't handle this carefully, we'll have Freeman and Thomas in here dictating to us what we can write and what we can't."

Lawrence has worked with Rick since he first came to the paper, and even though the two have had their share of conflicts, the relationship is primarily one of mutual respect and trust. "Let's just be careful," she emphasized. "Read the stories about big advertisers a little more carefully, make sure we can defend whatever we print, and it will all work out. I know this blurring of the line between advertising and editorial rubs you the wrong way, but Thomas is a reasonable man. We just need to keep him in the loop."

Late that afternoon, Rick received a story from one of his corresponding reporters that had been in the works for a couple of days. East Tennessee Healthcorp (ETH), which operated a string of health clinics throughout the region, was closing three of its rural clinics because of mounting financial woes. The reporter, Elisabeth Fraley, lived in one of the communities and had learned about the closings from her neighbor, who worked as an accountant for ETH, before the announcement had been made just this afternoon. Fraley had written a compelling human-interest story about how the closings would leave people in two counties with essentially no access to healthcare, while clinics in larger towns that didn't really need them were being kept open. She had carefully interviewed both former patients of the clinics and ETH employees, including the director of one of the clinics and two high-level managers at the corporate office, and she had carefully documented her sources. After this morning's meeting, Rick knew he should consult with Lisa Lawrence, since East Tennessee Healthcorp was one of the *Tribune*'s biggest advertisers, but Lawrence had left for the day. And he simply couldn't bring himself to consult with the advertising department—that political nonsense was for Lawrence to handle. If he held the story for Lawrence's approval, it wouldn't make the Sunday edition. His only other option was to write a brief story simply reporting the closings and leaving out the human-interest aspect. Rick was sure the major papers from Knoxville and other nearby cities would have the report in their Sunday papers, but none of them would have the time to develop as comprehensive and interesting an account as Fraley had presented. With a few quick keystrokes to make some minor editorial changes, Rick sent the story to production.

When he arrived at work the next day, Rick was called immediately to the publisher's office. He knew it was bad news for Freeman to be in on a Sunday. After some general yelling and screaming, Rick learned that tens of thousands of copies of the Sunday paper had been destroyed and a new edition printed. The advertising manager had called Freeman at home in the wee hours of Sunday morning and informed him of the ETH story, which was appearing the same day the corporation was running a full-page ad touting its service to the small towns and rural communities of East Tennessee.

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"The story's accurate, and I assumed you'd want to take advantage of a chance to scoop the big papers," Rick began, but Freeman cut his argument short. "You could have just reported the basic facts without implying that the company doesn't care about the people of this region. The next time something like this happens, you'll find yourself and your reporters standing in the unemployment line!"

Rick had heard it before, but somehow this time he almost believed it. "What happened to the days when the primary purpose of a newspaper was to present the news?" Rick mumbled. "Now, it seems we have to dance to the tune played by the ad department."

QUESTIONS

1. Why is Rick Arnold's news division losing influence at the *Daily Tribune*?
2. How might Rick have handled the ETH story in a more collaborative way?
3. Are there any power sources or political tactics that Rick might use to add to his influence as news editor? Explain.

CASE FOR ANALYSIS | The Burlington Plant

When Burton Lee took over as plant manager for the Burlington division of a large manufacturing company, he saw the opportunity to transform the lowest performing unit as a pathway to his promotion into top management.

Burton was aware of his reputation within the company as an intellectual, which he credited, in part, to an undergraduate minor in philosophy. Fifteen years after obtaining his MBA, he retained a passion for reading the classics—Homer, Tacitus, Plato, Herodotus, and Cicero—in the original Greek and Latin. Like Thomas Jefferson, he carried a pocket-size Greek grammar with him. Co-workers admiringly and grudgingly accustomed themselves to his familiar phrases, "*When you look at this logically . . .*" or "*it should be obvious that . . .*".

It was obvious to Burton that changes had to be made at Burlington. The division's reputation as the weak link in the company, with excessive machine downtime, backlogs, and complaints about quality negatively affected employee morale. In a down economy, rumors often circulated that the Burlington plant might be closed.

"My academic background taught me that there is a logical way to approach and solve problems. Manufacturing is often stuck in the past—*the way it has always been done*. Over and over in manufacturing you find that individuals in management have come up through the ranks and are reluctant to change—often even in the face of overwhelming evidence. Because they are stuck in this mindset, they are reluctant to explore ideas, to stay on top of manufacturing trends, or to see the bigger picture. I believe that innovation in thinking, in technology, in streamlining processes and empowering employees is crucial to success at Burlington.

"When I came here to take over Burlington, the plant was a mess, to put it bluntly. We were awash in paper. We were stuck on the traditional assembly line. When I talked to line supervisors, I felt like they were channeling Henry Ford. We needed a new paradigm, a new culture that was not stuck in the past. We had to end the backlogs, move product faster, and improve the quality. I can't do that. The workers in the plant have to do that. But they need the tools to work with. What was it that Churchill told FDR in World War II? 'Give us the tools and we'll finish the job.' That was the culture I wanted here in Burlington.

"I explored everything, talked to everyone, and investigated what was working in other industries. I knew we'd have to take these individual tasks and build a system to coordinate them into complex, but not complicated, interactions with specific targets that raise overall equipment effectiveness. The question was how could we do that?

"When you look at this logically, when you venture outside of your comfort zone and see what other industries have done, you discover a number of models and you find that there are resources in the form of technology and software out there that can help. I somehow managed to convince top management to invest in a pilot project with software that enabled us to create a virtual plant to look at every aspect of the operation—plant layout, material flow, machinery, everything. Initially, my on-site management team really got into this. With this software, we could simulate various problems and do some 'what-if' analysis. The idea was to create lean manufacturing clusters that could serve as a benchmark for the rest of the company.

"On the line, we moved toward dividing the assembly line into cells of self-managed teams. The idea is to empower and motivate the workers to make real-time decisions. Employees seemed enthusiastic and eager to have more control over the day-to-day operations. Supervisors were the first to balk, worried that they were losing prestige and that seniority was being shoved aside, as one long-time supervisor claimed, so that 'Joe Blow, who's only been on the line for ten months, can start making decisions.' Likewise, there were some line workers who balked. You would think that the opportunity to change from being essentially a cog in the wheel to becoming part of a dynamic, self-managed team would be appealing to everyone. But I guess some are afraid of decision making and feel a need for constant guidance. For some workers the mention of self-managed teams produced a 'deer in the headlights' reaction.

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"It should be obvious that these steps would bring improvement, but in order for this whole process to work, we needed worker cooperation and full management support. We had started making some progress and seeing some improvement in production and quality, when suddenly it was as if top management put on the brakes. We need resources and time to make the changes. Managers at other plants complained of preferential treatment for Burlington and argued that they were expected to produce and deliver while we were sitting around 'playing video games' and 'holding hands'—a reference, I'm certain, to the new software and the self-managed teams. Corporate repeatedly delayed funding for the new equipment and training that could transform this plant into a twenty-first century manufacturing division.

"I admit that I am shocked and disappointed that so many people in this organization fail to see the rationale here, which is obvious to anyone with eyes and a brain, and that they are failing to support our efforts. I'm showing them data that supports everything we're attempting here at Burlington. We're getting knee-jerk reactions when we need enlightened leadership. Now I'm wondering, what is the next step to go forward? A major success is being taken from me. And I heard informally that I am not a candidate for promotion."

QUESTIONS

1. What assumptions (rational or political) was Burton using in his initiative to improve the plant? Explain.
2. What was the underlying cause of the conflict in the case?
3. How do you think the workers viewed Burton's initiative? What might Burton have done differently to gain the cooperation of the workers? Explain.

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CASE 1.0

INTEGRATIVE CASE 1.0

Disorganization at Semco: Human Resource Practices as a Strategic Advantage*

"There is no contest between the company that buys the grudging compliance of its workforce and the company that enjoys the enterprising participation of its employees."[1]

-Ricardo Semler, CEO, Semco, in 1989

"For the past thirty years, this company owner has essentially blocked a "real" CEO from ruining his company by holding the position himself and refusing to rule. Instead, his employees rule, in what is one of the few truly democratic workplaces in all the world."[2]

-Ted Coine, Author and Speaker, in May 2011

Semco, based in São Paolo, Brazil, was considered by experts as one of the most innovative democratic workplaces in the world. Ricardo Semler, the majority stockholder of the privately-owned company, had essentially handed over total control of the company to the company's workforce. The company actively promoted the principles of democracy, transparent communications, constructive dissent, creativity, and employee growth.[3] The outcome was noteworthy—Semco's revenue, margins, employee strength, and business segments had expanded significantly.[4] The fact that the company had an inspired workforce was reflected in its low attrition rates. As of 2003, Semco's businesses comprised the production of industrial mixers, manufacturing of cooling towers for commercial estates, property and facility management services, environmental consulting, e-businesses, and inventory management. In 2007, Semco was also getting its hospitality business started and was dabbling in hospital and airport ventures.[5] Several observers were especially startled by the cultural metamorphosis that Semco had achieved, given the fact that, to begin with, it was a top-down-driven autocratic set-up. But experts wondered if the transformations at Semco would work in other organizations.

Background Note

Semco was established in 1953 in São Paulo, Brazil, by Antonio Curt Semler (Antonio), an immigrant from Austria. The company was most popular for the marine pumps that it manufactured. Nine-tenths of these pumps were supplied to Brazil's shipbuilders.[6] Semco was a strictly hierarchy-based company, which had regulations and policies governing every issue. Fear was the overriding maxim of the company at that time. Guards scouted the shop floor, regulated workers' visits to the washroom, and checked workers when they exited the factory premises.[7]

In 1982, Antonio's son, Ricardo Semler (Semler), aged 24, took charge of Semco. At the time of Semler's entry, the company was financially in dire straits. Semler started his stint as the new CEO by dismissing around 66 percent of the company's executives, many of them his father's confidants.[8] Initially, he focused on ensuring that the company remained solvent. After the company's financial condition improved, he moved to purchase other companies and explore new businesses.[9] To begin with, Semler, too, followed authoritarian practices, appointed managers who pushed the employees hard, and put in long hours himself. Despite Semco's speedy expansion, the overwhelming stress on output and on reaching stiff expansion targets exhausted the organization and had negative repercussions on management's

*This case was written by Tangirala Vijay Kumar, under the direction of Debapratim Purkayastha, IBS Hyderabad. It was compiled from published sources and is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of a management situation.

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relations with employees.[10] The hectic schedule also took its toll on Semler. On a particular day, while touring a pump factory near New York, he fainted on the shop floor. The doctor declared that he was essentially healthy but more mentally strained than any person aged 25 years that he had previously encountered.[11] After that incident, Semler resolved to harmonize his office and personal life better and to refashion his employees' lives similarly. Primarily, this entailed their enjoying their work lives.

At Semco, Semler started by clipping what he termed "corporate oppression". Sign-ins and sign-outs, attire rules, security checks, hierarchically reserved work areas, and allowances were all removed. The posts of receptionists and personal assistants/aides were done away with. All the employees had to receive their visitors themselves, fax their messages themselves, and prepare their own coffee.[12] The number of administrative staff was reduced by three-quarters. The top management was no longer entitled to exclusive dining halls or reserved parking lots.[13] Semler also allowed all his office employees to work flexible hours. To his pleasant surprise, he realized that the greater the autonomy that was bestowed upon Semco's employees, the greater was the adaptability, output, and trustworthiness that they displayed, and the more efficient Semco became.[14] Semler pushed further to democratize Semco and, according to experts, finally created an organization where employees were free to decide when, where, and how they worked and how they got paid for it.

Organizational Strategy

At Semco, there was no vision/mission statement or regulations manual. It also had no official organizational chart. When it was critical to portray the architecture of the organization, it was only drawn with pencil and was disposed of immediately.[15] The company's course was almost completely reliant on the zeal and creativity of its employees.[16]

Every business division of Semco had complete autonomy to expend its allocated finance as it deemed fit. Each of these business divisions had only a few hundred employees. Within each of these divisions, the practice was to form self-run teams, comprising 10 to 12 individuals, which manufactured a complete product and not merely an individual part. These teams themselves decided their strategies, courses of action, and outcomes and were answerable for them.[17] The small team sizes ensured that employees knew their coworkers well.

Since 1981, Semco had not budgeted for a period exceeding six months. Assessing the status of its business on a half-yearly basis enabled the company to keep up with the changing business scenario.[18] By means of a thorough budgeting and planning mechanism, each business was required to substantiate its continuation. The questions taken into account would be whether a business, assuming that it was not in existence, would be considered worthy of being floated and whether shutting a business would have a negative impact on Semco's relations with its key clients. If the answers were negative, both the financial and human resources were shifted to other businesses.[19] Analysts felt that Semco's businesses owed their resilience to these regular litmus tests to which they were subjected. Also, every six months, each of Semco's divisions estimated the number of employees it needed for the subsequent six months. This exercise also entailed every employee justifying his/her reappointment. Also, since the company did not plan for a period exceeding six months, it did not strategize the new businesses it intended to get into. Rather, Semco experimented with new businesses in a small way. Also, every Semco employee, through his/her vote, had a say in determining whether or not to purchase a new company.[20]

Semco goaded each team to consider itself as a tiny business unit. If a new business proposition that a team put forth was approved, it was the team's responsibility to conduct that business and it was allowed to retain a predetermined percentage, occasionally nearly 50 percent, of the ensuing profits. Consequently, Semco expanded from a small plant manufacturing marine and industrial machinery to an alliance of 16 enterprises, also comprising 10 online businesses, all funded by the respective businesses.[21] Also at Semco, any new business proposals that employees came up

[10]Lawrence M. Fisher, "Ricardo Semler Won't Take Control," www.strategy-business.com, November 29, 2005.

[11]Jaclyn Fierman and Therese Eiben, "Winning Ideas from Maverick Managers; Unconventional Leaders Share an Ability to Stun the Competition with Their Personal Brand of Can-Doism . . .," http://money.cnn.com, February 6, 1995.

[12]Charles Handy, "The Handy Guide to the Gurus of Management: Programme 11—Ricardo Semler," http://downloads.bbc.co.uk/worldservice/learningenglish/handy/semler.pdf.

[13]Ricardo Semler, *Maverick*, (Arrow Books, 1999).

[14]Brad Wieners, "Ricardo Semler: Set Them Free," www.cioinsight.com, April 1, 2004.

[15]Peter A. Maresco and Christopher C. York, "Ricardo Semler: Creating Organizational Change through Employee Empowered Leadership," http://www.newunionism.net/library/workplace%20democracy/SEMCO%20-%20Creating%20Organizational%20Change%20through%20Employee-Powered%20Leadership%20-%202005.pdf

[16]Simon Caulkin, "Stone Age Bosses Aren't All That Bad," www.guardian.co.uk, January 14, 2001.

[17]Kevin Herring, "Management in Real Life," www.hr.com, October 7, 2005.

[18]Fred Roed, "Brazilian Legend Ricardo Semler Challenges South Africans to 'Find a Better Way,'" www.ideate.co.za, September 21, 2011.

[19]Ricardo Semler, "How We Went Digital without a Strategy," http://hbr.org/2000/09/how-we-went-digital-without-a-strategy/ar/1?conversationId=2310899.

[20]Martin Simon, "Radical Works: A Different Kind of Employee Incentive," www.forburypeople.com, September 2009.

[21]Charles Handy, "The Doughnut Dimension," www.guardian.org.uk, January 16, 2005.

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with were vetted speedily and transparently. Each proposal was presented to an executive committee comprising emissaries from key business divisions. Any employee could be present at these meetings. Each proposal was required to fulfill the two conditions of operating in the premium segment and of the product or service being intricate, entailing engineering processes, and being difficult to get into. These conditions were even otherwise used to judge any new business that Semco was contemplating entering.[22]

Unlike most CEOs, Semler was not concerned about putting down in black and white the business segments that Semco operated in. According to him, he was neither aware of the business segments that Semco operated in nor keen to know them, as that would curtail employees' innovation, confine their thinking, and discourage them from exploring new avenues. This openness, according to experts, was the reason for Semco expanding from traditional production to services and further to cutting-edge Internet ventures.

Organizational Structure

Semler's efforts to change Semco's DNA partly included his tinkering with its organizational structure. Semco's initial structure was a functional one. This was a traditional pyramidal structure where the power was concentrated at the top and where it was difficult for employees to move up the ladder. Employees of each functional area such as manufacturing, sales, and accounts reported to the respective functional heads at the head office. Semler found that Semco's expansion was being slowed down by the bureaucracies and interdepartmental frictions inherent in a functional system. Semco briefly experimented with the matrix structure but found it ineffective. In 1986, Semco adopted a structure comprising independent business divisions, each headed by a general manager. It then decided to revert to the functional structure.[23]

After 1998, Semco designed for itself a radical organizational architecture comprising three concentric circles—a small one in the middle and two relatively bigger ones. The tiny circle in the middle comprised six individuals including Semler, akin to the vice presidential and higher cadres in traditional organizations. They were responsible for aligning Semco's overall plans and strategies and were referred to as Counselors. The second circle comprised the leaders of each of Semco's business divisions, referred to as Partners.[24] The biggest and outermost circle comprised all other Semco employees. The majority of them were referred to as Associates, and they were engaged in research, design, sales, and production jobs. This associate category comprised both permanent and temporary employees and the task heads who were specifically referred to as Coordinators. Coordinators included the sales, marketing, and manufacturing supervisors and foremen, who had elementary managerial responsibilities in the previous structure. These coordinators headed teams of associates.[25] None of the coordinators reported to the other coordinators, which effectively cut down the hierarchy. The number of organizational tiers was truncated from 12 to 3.[26]

Each of the six Counselors in the company assumed the CEO post on a half-yearly basis. This ensured that the financial/business performance of the company was not the responsibility of a single individual. According to experts, if the financial/business health of a company were to be a single individual's headache, all the others could afford to take it easy. But at Semco, each of the Counselors could hand over the CEO's post to others but had to reassume the position two and a half years down the line and deal with the situation prevailing then.[27]

Human Resource Practices—The Essence of Semco

Autonomy

All Semco employees were free to do what they desired. They individually determined their respective salaries/wages, their respective work timings, and their respective attires. Employees were not evaluated on the basis of the number of work hours that they clocked but on the basis of their meeting the set output targets. Clovis Bojikian, Semco's director of human resources as of 2003, explained, "We don't know how many hours any of our employees work weekly. Not even if they work at all. As long as you're getting the job done for yourself and the company, you're free to manage your own time."[28] According to Semler, Semco had been allowing its employees to work from home since 1981.[29] Employees were even encouraged to relax on Monday morning at the beach in case they had to stay back in the office on Saturday afternoon for work. Some experts appreciated Semco for providing hammocks in its gardens where employees could relax whenever they wanted.

Semco's principal policy was not to have any written policies and regulations, except for a short "Survival Manual" produced in comic-book style that got fresh recruits acquainted with its unconventional methods.[30] No one at

[22]Ricardo Semler, "How We Went Digital without a Strategy," http://hbr.org/2000/09/how-we-went-digital-without-a-strategy/ar/1?conversationId=2310899.

[23]Ricardo Semler, *Maverick*, (Arrow Books, 1999).

[24]Ibid.

[25]Ibid.

[26]Peter A. Maresco and Christopher C. York, "Ricardo Semler: Creating Organizational Change through Employee Empowered Leadership," http://www.newunionism.net/library/workplace%20democracy/SEMCO%20-%20Creating%20Organizational%20Change%20through%20Employee-Powered%20Leadership%20-%202005.pdf.

[27]Joan Lancourt and Charles Savage, "Organizational Transformation and the Changing Role of the Human Resource Function," *Compensation & Benefits Management* 11, no. 4, 1995.

[28]Roberto Guimaraes and John Southerst, "Semco: Work + Space = Freedom," www.oneworkplace.com, November 3, 2003.

[29]Sharon Shinn, "The Maverick CEO," www.aacsb.edu, April 25, 2012.

[30]"The Journeys of 2nd Tier Leaders over Time," http://integralleader-hipreview.com, March 2008.

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Semco had a permanent workstation; rather, they had to make their reservation on a daily basis. On a specific day, a top executive might be seated next to an intern.[31] The total operations at Semco revolved around the doctrine that employees needed to take their own decisions in the course of accomplishing their tasks. Penal rules were substituted by the common sense principle and by individual decision-making underlined by accountability for which employees were mentored.[32] For instance, Semco did not institute any travel-related regulations on those who needed to travel on work. Employees were free to take their own decisions regarding the mode of their travel. Being empowered in this aspect, employees did not have to waste time fulfilling micro aspects stipulated by a company's typical travel policy.[33] According to experts, autonomy and self-interest were vital elements of all activities carried out at Semco. Free of policies, procedures, and regulations, Semco's employees were answerable only to themselves. Semler explained, "People who are motivated by self-interest will find solutions that no one can envision. They see the world in their unique way—one that others often overlook."[34]

The main objective of equipping Semco's employees with workplace autonomies was to spur their creative thought processes. Semler explained, "People perform very badly when you assume they must be under control."[35] He felt that approximately 30 percent of productive time at organizations was devoted to petty issues such as dealing with employees who arrived late to the office, ensuring everyone attended meetings, making employees stay back late, etc. This resulted in the subordinates losing their initiative and accomplishing the minimum required to survive the scrutiny.[36]

The way human resources were treated at Semco had two underpinning beliefs. One was faith in grown-up behavior—the fundamental human urge to be productive, to strive for a better tomorrow, and to contribute to an endeavor of significance. The second was that each individual's functioning was distinct with regard to the time, place, and mode of delivering their best output.[37]

Doing Only What Was Needed

There was no compulsion for the employees to attend any of the meetings—if no one attended a meeting, it was an indication that its agenda for the meeting was worthless. Two positions at the board meeting were kept vacant for all the employees, to be filled up on a first come-first serve basis. Also, at meetings, employees were vigorously prodded to raise queries, to leave a meeting if they lost interest, and to attend any meeting whose agenda they were keen on. The ultimate objective was to focus on what really mattered and make productive use of time.[38] One of the company norms was that the employees had to restrict all circulars, reports, letters, and minutes to a single page. This forced them to focus on putting down only what was necessary.[39]

Bottom-Up Approach

The employees themselves nominated the corporate executives and triggered many of Semco's entries into new business arenas and its exit from existing ones. They could veto even the CEO's decisions.[40] Though Semler was the major shareholder at Semco, he had a single vote just like other company employees. One day, when Semler arrived at work, he realized that his personal cabin had been removed. His team decided that he did not require it and that the area could instead be utilized for another activity that could further business prospects.[41,42]

Joao Vendramin, who was heading the durable goods unit and was one of the CEOs, said, "Ricardo will say, 'If you want to know my opinion, I can give it to you now or later. But it's just another opinion.'"[43] Semler did not agree at all times with the decisions taken by the employees. However, at Semco, this was considered beneficial. It was felt that the more the autonomy and less the focus on a single person, the greater would be the robustness. A particular choice might even prove incorrect, but it was considered to be evidence of the autonomy and consistency that employees enjoyed and, hence, was viewed as being beneficial for the company's long-term health.[44]

[31]Roberto Guimaraes and John Southerst, "Semco: Work + Space = Freedom," www.oneworkplace.com, November 3, 2003.

[32]Sudam Chandima Kaluarachchi, "Is Management a Dream without Managers?" www.ft.lk, October 19, 2010.

[33]Langdon Morris, "Top-Down Innovation: Leaders Define Innovative Culture," http://www.realinnovation.com/content/c070528a.asp.

[34]Ricardo Semler, *The Seven-Day Weekend*, (Arrow Books, 2004).

[35]Stephen Moss, "Idleness Is Good", www.guardian.co.uk, April 17, 2003.

[36]"Brazil—The Caring Capitalist," www.journeyman.tv, July 4, 2005.

[37]Polly LaBarre, "Forget Empowerment—Aim for Exhilaration," www.managementexchange.com, April 25, 2012.

[38]Ibid.

[39]Martin Simon, "Radical Works: A Different Kind of Employee Incentive," www.forburypeople.com, September 2009.

[40]Greg Ferenstein, "How Brazil Is Blazing a Trail for Electronic Democracy," http://mashable.com, September 14, 2010.

[41]Colin Emerson, "Business: How Do You Become One of the Most Outstanding Leaders Ever in Your World?" www.ecademy.com, February 7, 2012.

[42]Ted Coine, Richard McGill Murphy, Marc Gunther, Edward E. Lawler III, Charles Erlcson, Aad Boot, and Simon Herrlott, *Return on Culture: New Perspectives on Corporate Governance*, http://sustainablebusinessforum.com/sites/sustainablebusinessforum.com/files/Return_on_Culture_Ebook.pdf.

[43]Jaclyn Fierman and Therese Eiben, "Winning Ideas from Maverick Managers; Unconventional Leaders Share an Ability to Stun the Competition with Their Personal Brand of Can-Doism . . .," http://money.cnn.com, February 6, 1995.

[44]Simon Caulkin, "Who's in Charge Here? No One," www.guardian.co.uk, April 27, 2003.

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EXHIBIT 1

Recruitment Procedure Followed at Semco

At Semco, if any team felt the need to recruit a new employee, the requirement was mentioned on the company's intranet, along with the date and time at which the selection criteria would be finalized. Any Semco employee was free to attend and aid the recruitment process. On the specified day, the interested employees would sit together and arrive at the selection criteria and advertise accordingly. If, for instance, 200 resumes had been received, they would be distributed for screening among the employees participating in the recruitment process. This procedure, by allowing employees themselves to screen the resumes, enabled the spotting of candidates who might not fit the immediate profile but might be suitable for other jobs in the organization. Also, the company employees, occasionally in dozens, jointly interviewed potential recruits. These candidates were free to come back to Semco any number of times to get clarifications on any concerns they had, which would help them in deciding whether or not to join the organization. This largely ensured that new employees fitted into Semco's culture, which was based on trust.

Sources: Brad Wieners, "Ricardo Semler: Set Them Free," www.cioinsight.com, April 1, 2004; Sharon Shinn, "The Maverick CEO," www.aacsb.edu, April 25, 2012.

At Semco, there were almost no official designations. All employees, including workers, chose their managers by vote. Even managers recruited from the outside were interviewed by the related team members. Explaining the idea behind employees themselves selecting their managers, Semler said, "We think it's better business when the boss is not simply imposed on people. If you're not involved in the choice of your boss, you are also free from commitment. When you ask, 'Do you like this boss or do you want that one?' the mindset changes dramatically."[45]

Leadership Earned

Leadership positions were considered to be vital and one needed to have followers to lay claim to a leadership role. Eligibility for leadership/managerial roles was periodically vetted by taking the approval of the managed. Every Semco manager was appraised on a half-yearly basis by his/her team members through 36 multiple choice questions. These questions were chiefly aimed at gauging the ability of the managers to motivate their team members and their capacity to accept their feedback.[46] The appraisal results were then displayed on the company's intranet. According to experts, the 36 questions proved that Semler expected managers to be calm, just, affable, capable of delegation, dependable, and efficient. Those rated low had to better their performance, failing which they were demoted.

Semco's personnel department was done away with as the leaders were expected to have the competence to deal with employees appropriately.[47] Only two individuals from the department were retained in the company to inform everyone about the developments in human resource practices elsewhere. As there was no personnel department, employees had to themselves determine whether they required a new team member and recruit one (refer to Exhibit 1 for the innovative recruitment procedure followed at Semco).

Transparency

Semco also maintained complete financial transparency. There was no information that could be categorized as confidential within the company.[48] All employees of the company were given the company's financials. Training sessions were conducted to enable all employees, including workers and cleaners, to comprehend the company's financial statements. Semco held a meeting every month where all employees participated in evaluating the company's finances. They could gauge what the company's turnover and payroll were, the reasons that set them apart from their rivals, and the reasons for the profits increasing or decreasing.[49]

All employees determined their respective salaries, which could be viewed by all on the company's intranet.[50] Explaining the rationale for providing unrestricted access to the salary details of all the employees, Semler said, "If you are embarrassed about the size of your salary you're probably not earning it."[51] Semco offered its employees a list of 11 diverse compensation payment choices that they could combine in any proportion (refer to Exhibit 2 for the different compensation options).[52] Some of these payment alternatives were fixed pay, allotment of company's shares, and commission on sales. Several of the employees opted

[45]David Creelman, "Thought Leaders: Ricardo Semler on a New Form of Management," www.hr.com, May 4, 2005.

[46]Robert Heller, "Business Leadership: To Be a Good Manager, You Have to Lead," www.thinkingmanagers.com, April 8, 2005.

[47]"When Happiness Is Your Driving Force in Business," http://health2organisations.com, March 3, 2010.

[48]Adrian Gaskell, "Should Your Salary Be Public Knowledge?" www.managers.org.uk, July 16, 2009.

[49]Ricardo Semler, *The Seven-Day Weekend*, (Arrow Books, 2004).

[50]Nick Easen, "Democracy in the Workplace," http://edition.cnn.com, May 20, 2004.

[51]Wayne Visser, "The Age of Responsibility: CSR 2.0 and the New DNA of Business," *Journal of Business Systems, Governance and Ethics* 5, no. 3, http://www.jbsge.vu.edu.au/issues/vol05no3/Visser.pdf.

[52]Simon Caulkin, "Few Options Left for Meg, Jeff and Tim," www.guardian.org.uk, March 18, 2001.

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EXHIBIT 2
Semco's Compensation Options

1. Fixed salary
2. Bonuses
3. Profit sharing
4. Commission
5. Royalties on sales
6. Royalties on profits
7. Commission on gross margin
8. Stock or stock options
9. Initial Public Offering (IPO) or sale (could be availed of only when a specific business division went for an IPO or the division was sold)
10. Self-set yearly appraisal/compensation (wherein an employee was paid for achieving self-determined targets)
11. Value added, a percentage of the difference between the present and the future, three-year worth of the company

Source: Ricardo Semler, *The Seven-Day Weekend* (Arrow Books, 2004).

for a portion of their salaries to be given in the form of profit apportioning plans, an indication of their confidence that their employer would offer them a better return on their money than compensation in hard cash.[53]

Individual Driven

Semco emphasized that employees strive for personal challenges and gratification before working toward the organization's goals.[54] He believed that if the employees of an organization led balanced lives, the entity would remain healthy. And, according to him, the balance could be attained when employees were given room to figure out their strengths and likings and align their individual ambitions with organizational objectives. Once they were stimulated and energized, their endeavors would automatically lead to fruitful organizational development. Job rotation was actively promoted across the organization as Semler was of the view that many of the employees were the products of an education system that forced them to decide on their career paths early in their lives when they had insignificant knowledge and no clue about occupations. The company's employees were given the freedom to search for jobs in which they were interested. They could opt to be a part of any team subject to there being a vacancy, their skill sets being the required ones, and the team members being open to their inclusion.[55] According to commentators, every Semco employee was in charge of his/her individual career. Semco funded the training programs that each was interested in, irrespective of the area of learning, subject to a budget.

Semco did not have an information technology department. Each Semco employee was free to buy information technology infrastructure of his/her choice. This ensured that he/she took the advice of many individuals and purchased a device that was the latest and the most updated. This minimized the risk of technological obsolescence. If an employee bought an exorbitantly priced device, his performance was expected to match up to the bill that the organization had to foot for the device.[56] Also, according to Semler, by avoiding centralized purchase of information technology requirements, Semco did away with the procedure followed by conventional companies of collating the requirements of all the departments and inviting tenders and then realizing that the devices that they had bought were inferior to speedier and more efficient new launches.

A Balanced Approach

The freedom bestowed upon employees was tempered by certain measures. One such measure was peer group scrutiny of employee activities. This discouraged employees from taking advantage of the system by, for instance, unnecessarily traveling in business class, as their counterparts would evaluate their expenses. One more of Semler's important techniques was the rewarding of employees with variable compensation. Their compensation—23 percent of each business unit was apportioned among that division's employees—was directly related to the company's performance, motivating every one of them to consistently work at their best.[57,58] Semco also created certain conditions to ensure that employees set their individual salaries appropriately. It provided employees with the details of salaries that employees in other companies received. The salary details of every employee in the company, in any case, were known

[53]Ricardo Semler, *The Seven-Day Weekend*, (Arrow Books, 2004)

[54]Gary A. Yukl and Wendy S. Becker, "Effective Empowerment in Organizations," *Organization Management Journal* 3, no. 3, 2006.

[55]Kevin Herring, "Management in Real Life," www.hr.com, October 7, 2005.

[56]Brad Wieners, "Ricardo Semler: Set Them Free," www.cioinsight.com, April 1, 2004.

[57]Mark Hillary, "Brazil IT Management Needs Transparency," http://itdecs.com, April 6, 2012

[58]Dave Gray, "A Business within the Business," www.dachisgroup.com, November 28, 2011.

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to every other employee, and the financial condition of the company could be gauged from its financials.[59] Moreover, all work was accomplished in small teams where work was apportioned in such a manner that each employee had a clear idea of how he/she contributed to the company. Hence, according to an expert, employees could determine their salary in a fair manner as they had access to three crucial details: they were aware of their market worth, they were aware of how their output fitted into the team's output, and they were aware of the company's financial condition.[60] Also, the salary of each employee was subject to perusal by others.[61] If an employee set his/her salary unusually high and his/her performance did not match up to it, that individual ran the risk of not being selected by any of the teams when they were formed anew after six months.

Production Staff—Brothers in Partnership

At Semco, the worker committees administered the factories.[62] These committees regularly held parleys with the executives of each plant. The committees had a say in expense reductions, in making significant alterations to product lines, and, during difficult times, in choosing the employees who would face the axe.[63] Workers, of their own volition, performed multiple tasks. On a typical day, depending upon the output goals, a lathe operator might opt to concurrently handle a grinder or steer a forklift.[64]

According to experts, one of the distinctive aspects of Semco's work culture was the company's production staff determining their respective work hours. Generally, they jointly decided the time at which they should be at work. In the 1980s when Semco was to introduce flexible work timings for workers in the manufacturing line, the production executives were up-in-arms against the initiative as they felt that it would infringe on the elementary assumption that for a manufacturing set-up to function, each of the individuals involved had to work during the same hours. Semler's response was that if the workers were not operating at a particular time, the manufacturing line would come to a standstill. As grown-ups, even the workers were aware of this and also of the fact that they would be jobless if there was no output. And, according to Semler, if the workers still did not care about the company's productivity, it would be more ominous for the company in the long run. Also, it would be in the best interests of the company to be aware of this fact early. The day before the flexible hour policy was implemented, the production workforce came together and agreed on their work timings.[65]

Single-Minded Focus on Performance

The Semco employees who contributed little did not remain unscathed. To remain in the organization, an individual had to be required by any of the teams for the subsequent six months, which could not be achieved by indulging in politics. Semler explained, "It's as free market as we can make it. People bring their talents and we rely on their self-interest to use the company to develop themselves in any way they see fit. In return, they must have the self-discipline to perform."[66]

It was not lost on some observers that the freedom given to employees to determine their respective work hours ultimately enhanced the organizational productivity. Semler elaborated, ". . . if you wake up in a bad mood on Monday morning, you don't have to come to work. We don't even want you to come because you simply don't feel like it and will therefore not make a contribution. We want employees who are ready and willing to work. If that means they only come twice a week, that's okay. It's about results."[67]

The overwhelming stress on objectivity also led to the company's head office being dismantled and replaced by satellite offices akin to the airport lounges scattered across São Paulo. Employees were deprived of not only permanent workstations but also of permanent offices. According to Semler, "They thought it was about location. In fact, it's about eliminating control. If you don't even know where people are, you can't possibly keep an eye on them. All that's left to judge on is performance."[68] Another objective of closing the head office was to cut down the time employees spent battling São Paulo's traffic to reach the office. Semco calculated that one million hours per annum were devoted to travelling to and fro. Hence, it was decided that Semco's employees would work in smaller settings closer to home.

Semco encouraged its employees to take afternoon naps—something looked down upon in conventional companies—in the hammocks. Semler believed short spurts of sleep in the afternoon were a part of the natural body rhythm and helped in re-energizing employees.

[59]David Creelman, "Thought Leaders: Ricardo Semler on a New Form of Management," www.hr.com, May 4, 2005.

[60]Balaji Pasumarthy, "Do You Want to Decide Your Own Salary?" http://wealth.moneycontrol.com, November 6, 2008.

[61]Tammy Erickson, "Should Your Coworkers Know How Much You Make?" http://blogs.hbr.com, April 25, 2009.

[62]Nick Easen, "Democracy in the Workplace," http://edition.cnn.com, May 20, 2004.

[63]Martin Simon, "Radical Works: A Different Kind of Employee Incentive," www.forburypeople.com, September 2009.

[64]Lawrence M. Fisher, "Ricardo Semler Won't Take Control," www.strategy-business.com, November 29, 2005.

[65]Francisco Trindade, "Focus on the Right Point," http://blog.franktrindade.com, August 12, 2008.

[66]Simon Caulkin, "Who's in Charge Here? No One," www.guardian.co.uk, April 27, 2003.

[67]Dominique Haijtema, "The Boss Who Breaks All the Rules," http://odewire.com, January 21, 2007.

[68]Simon Caulkin, "Who's in Charge Here? No One," www.guardian.co.uk, April 27, 2003.

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Semco adhered to a six-month strategy rather than a one-year one that most other companies adopted as the management did not want its employees to emulate their counterparts in other companies who got things moving only in the second half of the financial year.

Lessons in Surviving Economic Crises

According to observers, Semco's robustness was in full display during the 1990s when the Brazilian economy was in the doldrums. At a time when Brazil's gross industrial product declined by 14 percent, 11 percent, and 9 percent in 1990, 1991, and 1992, respectively, when the country's capital equipment production contracted to the 1977 position, and when 28 percent of its capital equipment producers went bust, Semco managed to maintain its revenue and profit momentum. This was made possible by certain radical shifts implemented by Semco and, more importantly, its employees. In 1990, Semco too had frequently been staring at nil monthly sales and employee retrenchment had become imminent. At that stage, Semco's workers took the initiative and proposed to take a 30 percent reduction in wages, subject to their slice of profits being enhanced to 39 percent, management pay being reduced by 40 percent, and their being entitled to vet every expense. They also themselves executed several tasks that had previously been outsourced, like preparing meals, cleaning, guarding the plants, delivering the end products to the customers, and hawking the replaced components.[69] The changes brought about during that period resulted in a 65 percent decline in inventories, a significant compression of product delivery times, and a product defect percentage of below one percent.[70] As the economic situation became better, Semco's financial outlook stabilized.

Despite Semco's financial health being restored, the company's management felt that, given the fragility of the Brazilian economy, Semco's operational and financial efficiencies could only be sustained by reducing its permanent workforce and outsourcing some of the operations. Semco's management preferred assigning the work to employees who might get the axe to outsourcing the jobs to outsiders.[71] These employees were encouraged to exit Semco and set up their respective satellite firms and, to begin with, get subcontracts from Semco. These subcontractors were allowed to lease Semco's machinery and could, further, operate from Semco's factories. They could get orders from other companies and still execute them deploying Semco's machines. Initially, they did not have to pay lease charges for using Semco's machinery and its other infrastructure. Semco benefited in terms of reduced expenses, both salaries and inventory, and by getting the work executed by individuals who knew its requirements inside out.[72] Making entrepreneurs out of Semco's employees took their commitment, which was already robust, to the next level. As of 1998, nearly 66 percent of Semco's new products were produced by these satellite firms, and 66 percent of its workforce operated through these units.

Impact

Semco was a privately held company that did not disclose its financials. Its turnover had increased from US$4 million in 1982 to more than US$1 billion by 2007[73,74] (refer to Exhibit 3 for the increase in Semco's revenues over the years). And, according to Semler, Semco was clocking average yearly revenue and bottom-line growth of 40 percent.[75] Semco's success could also be gauged from the fact that an investment of US$100,000 in 1985 would have yielded an additional US$5.3 million by 2005.[76] Its employee strength had increased from 90 in 1982 to 5000 by 2007.[77,78] And, according to experts, the fact that repeat clients accounted for nearly four-fifths of Semco's yearly turnover of 2003 indicated the company's client retention abilities.

According to observers, Semco earned significant goodwill because of the freedom it gave its employees (refer to Exhibit 4 for some of Semco's innovative employee programs). At Semco, at times, there would be gaps of up to

EXHIBIT 3

Annual Revenues of Semco (US$ million)

1980	4
1994	35
2001	160
2003	212
2007	>1000

Sources: https://socialimprints.com/pages/empowering-the-community; Ricardo Semler, *The Seven-Day Weekend* (Arrow Books, 2004); A.J. Vogl, "The Anti-CEO," *The Conference Board Review*, May/June 2004; Kerry O'Brien, "Interview with Semco's Business Guru," www.abc.net.au, June 3, 2007.

[69]Ricardo Semler, "Why My Former Employees Still Work for Me," *Harvard Business Review*, January 1994.

[70]"BRIC is Next," http://sephisemagazine.org/contemporary-south/bric-is-next.html.

[71]Ricardo Semler, "Why My Former Employees Still Work for Me," *Harvard Business Review*, January 1994.

[72]Kelly Killian, Francisco Perez, and Caren Siehl, "Ricardo Semler and Semco S.A.," http://www.thunderbird.edu/knowledge_network/case_series/1998/_98-0024.htm.

[73]https://socialimprints.com/pages/empowering-the-community.

[74]Kerry O'Brien, "Interview with Semco's Business Guru," www.abc.net.au, June 3, 2007.

[75]Polly LaBarre, "What Does Fulfillment at Work Really Look Like?" http://management.fortune.cnn.com, May 1, 2012.

[76]Lawrence M. Fisher, "Ricardo Semler Won't Take Control," www.strategy-business.com, November 29, 2005.

[77]"BRIC is Next," http://sephisemagazine.org/contemporary-south/bric-is-next.html.

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EXHIBIT 4
Some of the Innovative Employee Programs at Semco

Retire-A-Little (RAL): This program was based on the premise that employees in their 30s and 40s might not be able to pursue their hobbies and interests due to financial constraints. However, when they were in a financially comfortable position in their 60s, they did not have the physical wherewithal to pursue their interests. Under RAL, an employee could take time out, possibly for half a day in a week, to engage in his/her personal pursuits, which would also entail a slight deduction in the monthly salary. After retirement, he/she could redeem from Semco the deducted salary by working the corresponding number of hours.

Lost In Space (LIS): Under LIS, for one year, every young entrant into Semco was free to do whatever he/she desired, work in any of Semco's business divisions, or hop across any number of divisions he/she wanted to. However, after the completion of a year, if none of the divisions where an entrant worked came up with a job offer or if the entrant did not find anything interesting, he/she had to quit. LIS was based on the premise that under the prevailing education system, adolescents were pressured by their parents to choose a particular career path, which might ultimately not fully unlock their potential.

Up'n Down Pay (UDP): Under this program, employees had the flexibility to adjust their compensations based on certain situations in life. An individual could reduce the number of his/her working hours or responsibilities due to factors such as taking care of infant children. There would be a corresponding reduction in pay.

Work'n Stop (WSP): Under WSP, employees could take extended breaks of up to three years to pursue studies or their interests or to introspect on where they were headed.

Rush Hour MBA (RHM): The RHM program, conducted once every week for two hours starting at 6:00 P.M., was devised to enable Semco's employees to avoid São Paolo's heavy traffic and simultaneously make productive use of their time. Any of Semco's employees could volunteer to lecture to the employees on a subject of his/her interest or to tell them about an interesting article he/she had read recently. The two hours spent allowed employees to not only enrich themselves but also to reach home faster upon completion.

Source: Ricardo Semler, *The Seven-Day Weekend* (Arrow Books, 2004).

fourteen months before an employee resigned from his/her job. At any point in time, the company had to process at least 2,000 job applicants, with several of the applicants being prepared to take up any work offered to them at Semco.[79] Also, according to Semler, the yearly attrition rate at Semco had been below two percent since 1981.

Some experts felt that the true impact of the employees being at the helm of affairs in the organization was felt in the resilience that Semco developed. This became clear when, in February 2005, Semler met with a near-fatal accident and had to be in the intensive care unit for an extended period of time, recovering from the multiple operations he had to undergo. During this time, Semco operated smoothly—targets were reached and agreements sealed, and there was no disruption to business.[80] Semco had reached a stage where it was not dependent on a single individual, not even Semler. At least for 10 years since 1993, Semler had not taken a single decision at Semco.[81] He had no role in initiating businesses that contributed to three-fifths of Semco's turnover as of 2006.[82]

A result of Semco's steadfast adherence to placing faith in employee choices regarding the time when they worked, how much they were paid, deciding themselves whether or not to skip meetings, and purchasing their own information technology infrastructure was an intensely faithful and productive workforce.[83] According to a long-serving Semco employee who had started small and had worked her way up Semco's ladder, "In all these years, Semco never discounted a minute's worth of salary, even when I was late or absent. I take a reciprocity position. When Semco needs me, I am there. When my brother got sick, I was gone for four days and Semco didn't discount a penny from my cheque. In turn, I haven't claimed overtime for the weekends I worked . . . There's a virtuous circle in place that requires no overt declaration."[84]

Constraints to Replication?

Though Semco's radical management practices had indicated that they could result in profitable and sustainable growth, experts were skeptical about the extent to which these tenets could result in similar successes in other companies, genuine though their efforts might be. Their skepticism had its roots in the deliberate strategy chosen by Semco of being present only in businesses that entailed significant levels of engineering/complexity (this ensured that the barriers to entry for other aspirants in terms of technological competence required were high); of being only a premium player in each of its product/service segments; and of carving out a distinct niche in each product/service segment, which ensured that Semco was a prominent player in the concerned industry.[85] Experts

[79]J. Patrick Murphy, "We Want the Best," http://las.depaul.edu, September 26, 2008.

[80]Lawrence M. Fisher, "Ricardo Semler Won't Take Control," www.strategy-business.com, November 29, 2005.

[81]Simon Caulkin, "Who's in Charge Here? No One," www.guardian.co.uk, April 27, 2003.

[82]Dominique Haijtema, "The Boss Who Breaks All the Rules," http://odewire.com, January 21, 2007.

[83]Edward H. Baker, "Editorial: April 2004," www.cioininsight.com, April 1, 2004.

[84]Ricardo Semler, *The Seven-Day Weekend*, (Arrow Books, 2004).

[85]Ibid.

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wondered whether a company operating in a product/service segment that was easy for others to enter, which was not present in a premium or a niche segment—this meant that economies of scale could not be ignored—could afford to bestow similar freedoms upon its employees. Some commentators also observed that Semler, being the majority shareholder in a privately held company, had the luxury of trying out his radical ideas. Would it be within the realm of possibility, they wondered, for a large public company with diffused ownership to embark on such a journey? So, would relinquishing control, described by Semler as Semco's competitive advantage, be limited to just one company?

Questions

1. How would you describe Semco's organization design before and after the changes implemented by Ricardo Semler?
2. In what ways is Semco's design similar to and different from the holacracy structure described in Chapter 3?
3. Describe the rather unusual Human Resource policies now in effect at Semco.
4. How did Semco handle downsizing during a weak economy? How did that approach benefit the company?

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INTEGRATIVE CASE 2.0

Walmart's Failures in Entering Three Developed Markets*

CASE 2.0

Walmart, the largest retailer in the world, has been pursuing international markets for nearly 30 years as its domestic markets reached saturation. Three market entry fiascos from Walmart's aggressive international expansion are analyzed in this case. Interestingly, these failures took place in developed market countries; Germany, South Korea, and Japan. They represent enormous levels of financial loss, as well as stunning setbacks to global expansion for the firm.

Although international operations have been lucrative for Walmart, the firm has faced certain obstacles along the way. They had hoped to duplicate their dynamic business model seamlessly in other high-potential markets by building robust supplier networks due to their gargantuan size and proven ability to influence pricing, particularly through zealous inventory management via elaborate supply chain systems. Starting with Mexico in 1991, they have steadily entered new markets and by the end of 2018 foreign operations consisted of 11,718 stores in 30 countries. Fifty-five percent of Walmart' stores are now outside the United States. Exhibit 1 outlines this data. They do not officially disclose international sales figures by country, except to say that they receive 28 percent of their total revenue from outside the US.

Walmart's growth has, however, been tainted by an inability to adapt in some markets to local consumer customs, culture and tastes. As a multinational enterprise, Walmart's initial 1991 penetration into foreign markets continues to be highly successful. However, when Walmart entered Germany and South Korea in the late 1990s through acquisitions, it found itself saddled with undesirable locations and was unprepared for the cultural challenges. Expansion into the Japanese market in 2002 was one of its most ambitious joint ventures as it sought to leverage the familiarity of a large, well-known domestic chain Seiyu, in which they purchased a minority interest. Ultimately Walmart suspended operations in Germany and South Korea in 2006 and was able to continue operations in Japan under the Seiyu brand. Exhibit 2 provides a summary of international expansion activities.

*F. Robert Buchanan, Tracey L. Missien, and Hussam Al-Shammari

EXHIBIT 1

Leading Global Retailers – Size Ranking/Country Count/Sales Revenue (as of 2018)

(Companies included have at least 1/3 of their sales from food)

	No. of Countries	No. of Stores	Sales $ (billions)	Global Ranking	Base Country
Walmart Inc.	30	11,718	$500.3	1	USA
Carrefour SA	35	6,729	$89.2	3	France
Aldi	17	12,080	$85.0	8	Germany
Tesco PLC	10	3,356	$74.1	5	UK
Groupe Auchan SA	13	3,873	$63.8	14	France
Rewe Group	11	4,618	$65.3	21	Germany
Casino Guichard	29	3,594	$45.4	13	France
Aeon Co., Ltd.	10	4,346	$75.65	17	Japan
E. Leclerc	7	707	$50.7	23	France

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EXHIBIT 2

Selected Wal-Mart International Retail Operations (as of 2014)

	Mexico	Puerto Rico	Canada	Argentina	Brazil	China	Germany	South Korea	United Kingdom	Japan	Central America[3]
Date of Market Entry[1]	Nov-91	Aug-92	Nov-94	Nov-95	Nov-95	Aug-96	Dec-97	Jul-98	Jul-99	Mar-02	Sept-05
Mode of Entry	Joint Venture	Start Up and Acquisition	Acquisition	Start Up and Acquisition	Joint Venture	Start Up and Acquisition	Acquisition	Acquisition	Acquisition	Joint Venture	Joint Venture
Operating Name	Walmart de Mexico	Walmart Puerto Rico	Walmart	Walmart Argentina SA	Walmart Brazil	Walmart China	Walmart Germany	Walmart	ASDA/ Walmart	Seiyu, Ltd.	Walmart Central America
No. of stores[2]	2,290	55	394	105	557	411	592	16	592	431	690
Sales $[4]	$32 billion	$2.5 billion	$23 billion	$3 billion	$7.5 billion	$2 billion	0	0	$35 billion	$7 billion	$3.5 billion[5]
Date of Market Exit	-	-	-	-	-	-	Jul-06	May-06	-	-	-

[1] Yoffie & Slind, 2007.

[2] Walmart (http://corporate.walmart.com/our-story/locations)

[3] Includes Costa Rica, El Salvador, Honduras, Guatemala and Nicaragua.

[4] Estimated. Not officially reported in company financials. Most recent available: 2013. Multiple web sources.

[5] Sales combined.

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Germany

Germany was Walmart's first European entry. They started in December 1997 by acquiring Wertkauf stores with 21 locations in the southern area of the country. Within months, Walmart acquired Interspar with over 70 stores in the northern region. They believed, as do many American companies, that expansion into Europe by way of Germany makes sense due to similarities in culture, language, and legal environment. Executives assumed that acquiring the two German retailers and then changing them to the Walmart name was a solid entry strategy, but they quickly learned of the operational differences between the two chains and that their locations and appearance were far below the average American standard. Other problems were related to Walmart's lack of Germans in management roles. The company never disclosed the full amounts of its operating losses in Germany. Analysts estimate annual losses at $200 to 300 million per year during Walmart's time in the country.

South Korea

It could be concluded that Walmart sought entry into South Korea due to the country's rank among the top 15 economies in the world and dense population. In July 1998, Walmart acquired South Korean retailer Makro, which owned four stores and six undeveloped sites and employed over 800 people. Even though Walmart studied the market for four years and saw other multinational corporations fail (Nestlé, Nokia), it nevertheless proceeded into the South Korean market, unprepared for the local conditions that they experienced. After losses increased to $150 million in 2005, Walmart sold its 16 stores to its main South Korean competitor E-mart, which already had 86 stores and 30 percent of the South Korean discount market.

Japan

Walmart entered Japan in May 2002 through a joint venture by purchasing a six percent stake in Seiyu Ltd., Japan's fifth largest supermarket chain with over 400 stores. They retained the Seiyu name on the storefronts but stocked through Walmart's supply chain, gradually increasing ownership share. In 2008, Walmart acquired full 100 percent interest in Seiyu. By entering Japan with a local partner, Walmart hoped to better navigate the entrenched operations of manufacturers and middlemen in a country whose historically high cost structures have made an unfriendly environment for foreign discount retailers. Japanese customers are known to be extremely finicky and the Seiyu joint venture was a way to gain advantage by aligning with a recognizable brand name to penetrate the heavily populated market. However, at the time of entry, Japan's economy was experiencing lackluster retail sales and intense competition, all factors that continue to exist. Walmart's disappointing Japanese operations continue to this day to be far underperforming their potential.

Marketing

Much has been written about Walmart's retail model. In terms of the customer, the retailer seeks to provide as many products as possible at one location, at the lowest prices possible. On the supply chain side, because they have so many customers, they can pressure suppliers to reduce the cost of the goods due to large volume purchasing. To articulate Walmart's success in devising an integrated marketing strategy, it is worth looking at marketing expert Philip Kotler's four Ps of marketing.

Four Ps	Four Cs
Product	Customer Solution
Price	Customer Cost
Place	Convenience
Promotion	Communication

The Ps represent the sellers' view of the marketing tools available for influencing buyers. From the buyers' perspective each "P" has a corresponding customer "C" such that companies that can meet consumers needs economically, conveniently and with effective communication are the most successful.

Price: Customer Cost

Walmart's basic generic strategy is cost leadership. Walmart's everyday low prices strategy, i.e. value-pricing – where prices generally remain consistently low – places less emphasis on advertising and more on product availability and large sales volume. When consumers have many shopping alternatives, price can become less important relative to the total shopping experience, particularly in a comparatively affluent market. In other markets, consumers can be very price conscious. Thus, the pricing strategy is of great importance in determining overall strategy.

When Walmart entered Germany and South Korea, discount retailing was already entrenched, and Walmart found itself unable to negotiate with suppliers to achieve the most advantageous economies of scale. As a result, they were unsuccessful in offering the lowest prices to highly price conscious German consumers. However, with South Korean consumers, price is not necessarily the most important element when compared to consumer preferences for convenience, quality and choice so the EDLP (Every Day Low Pricing) approach carried little appeal. In comparison to Walmart competitors, Korean shoppers did not find Walmart's prices on domestic items to be impressively lower and continued to prefer stores that carried both discount and luxury items. Customers in Japan are by far the most discriminating shoppers in the world, with an eye for designer products and name brands. As a result of having one of the highest per capita income

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levels, they place more emphasis on product choice/quality rather than price, and in fact perceive cheap prices to indicate low quality.

Germany. Accustomed to being a price leader in groceries, Walmart was never as cheap as its well-established competitor Aldi, which had 4,100 stores in Germany at the time Walmart pulled out.

Thus, they were not successful with their American style of predatory pricing to force competition out. In fact, entrenched competitors were proactive in price cutting and were able to "out-Walmart" Walmart. Additionally, local fair trading laws prohibited some of Walmart's favorite "loss-leader" tactics.

Japan. Low prices have not been attainable in Japan. Operating expenses are known to be three times higher than North America, and manufacturers do not sell directly to retailers.

Quality is more important than cheap prices for Japanese retail customers. This creates a structural problem for Walmart's business model of Every Day Low Pricing.

Any price sensitivity of Japanese customers is trumped by their expectations of quality. It is a unique and nuanced combination of attributes that are valued in this market, which foreigners find hugely challenging to comprehend.

South Korea. Similar to Japan, South Korean buyers did not respond to Walmart's pricing advantages because of their priorities of favoring product mix and attractive surroundings.

Product: Customer Solution

Our research revealed several errors with Walmart's approach to product mix due to failure to address cultural differences and the impact of tradition. Tradition can be particularly important in grocery items and beverages and the retailer did not properly formulate localization strategies. These three markets had similar entry barriers including economies of scale, product availability, and supplier relationships – variables that are typically not constraints for the retailer's U.S. operations. Walmart experienced a pattern of difficulties with suppliers including logistical access, product access (e.g. fresh vs. frozen foods) and contracting.

The merchandise that Walmart needed to stock shelves was not much different from what local competitors also needed. If Walmart was to compete, it had to stock the same items, preferably at a lower price. But as it tried to purchase merchandise, especially in South Korea, Walmart found that the competitive environment and limited quantities kept it from finding suppliers that it could partner with to purchase the right ethnic products at low cost. Consequently, the retailer could not advantageously fulfill local tastes, and ultimately failed to win market share that would allow it to put pressure on suppliers. Walmart leapt into the markets overestimating its buying power and underestimating the competition. Even product packaging preferences were not tested for consumer acceptance. In Japan, Walmart currently faces a complex supply network that is resistant to change. Walmart's supply chain simplification was resisted by Japan's multi-tiered distribution system, where access to suppliers is limited to protect already small profit margins.

Merchandising Styles That Did Not Translate

Germany. Walmart's merchandising style is to place premium products at eye level, with the discount items harder to find. Germans found this to be quite annoying. This included the attempt to entice Germans with packaged meats, when they prefer to buy from a butcher. Walmart could not fully leverage its supply chain advantages in Germany because they were not big enough to force suppliers to conform to their demands the way they could in America. Supplier relationships were not good. As a result, they could not force compliance with their preferred supply chain and logistics demands, which includes access to suppliers' operations and quality control.

South Korea. Because Korean consumers have smaller homes, they prefer small, compact packaging vs. large. Walmart's bulk packaging missed the mark. The marketing mix of dry goods, boxed products, electronics, and clothing was not attracting Korean housewives who like to see beverages and fresh food in the stores. Chief rival E-mart was popular with its entertainment style of active colorful displays and clerks with food samples who would be clapping their hands and using megaphones.

Japan. The big box store format and larger bulk packages popular with Walmart does not match the shopping style of Japanese, either. In this country people think 'minimalist' in their space utilization, especially with the small size of their homes. Small convenient neighborhood stores near to home are the most sensible to them.

Place: Convenience

Germany. In Germany, Walmart slumped when it could not break into existing supplier relationships and then by placing its supercenters outside the city limits (outside of where most of the population dwells). They found that consumers were unwilling to travel to stores just to discover that they that did not stock the desired products at the best prices. Walmart's purchase of Wertkauf and Interspar stuck them with unattractive real estate in bad locations. They only bought about one percent of the retail market with these acquisitions, which were both losing money at the time of purchase. Meanwhile, zoning restrictions and the lack of large undeveloped land hindered Walmart's expansion into superstore locations.

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Germans like to shop efficiently and spend as little time as possible. Walmart uses the American merchandising style of placing popular items at distant corners, forcing the customer to walk through a great amount of merchandise. Local patrons did not like this retailing scheme.

South Korea. Stores in South Korea were perceived as unattractive and inconvenient. Shelves were taller than usual for retail, causing customers to climb. Walmart's standard utilitarian design, in which ceilings had exposed pipes and structure, put off customers as being ugly and cheap compared to local merchants. In South Korea, even low-cost retailers such as E-Mart, which is the largest South Korean supermarket, have attractive store spaces that do not convey cheapness. Local customers prefer such stores, especially female shoppers. They do not like the warehouse atmosphere of a Walmart.

Japan. Walmart made a wise choice in retaining the existing name and store infrastructure of Seiyu. It was a type of market entry that later worked even better and on a larger scale in the UK with their ASDA acquisition.

Promotion: Communication

International audiences have very different perceptions that fuel their response to marketing communications. Walmart mistakenly adhered to western-style advertising approaches that either did not fit the cultural norm or were ineffective due to pricing and lack of product choice. In Germany they faced price advertising restrictions. South Koreans and Japanese were disinterested in weekly sales circulars. As discussed, because Walmart could not stock the right products at the right prices, advertising became somewhat useless as a tool to drive market share and growth. Had Walmart researched the cultural factors in these markets, it would have found the need to vary its mix country by country.

Germany. Since Walmart was not able to achieve cost leadership status in Germany, their promotional efforts were not useful. Attempts to create promotional 'loss leaders,' as would be found in the United States, crossed ethical and legal boundaries in Germany. The American retail service culture was foreign to German shoppers (Helm, 2000). Walmart's 'ten-foot rule' annoyed shoppers, especially when workers were trained to come at them smiling, which conveys the wrong message in Germany. Even having a worker to bag the customers' groceries was perceived as an annoyance.

South Korea. Walmart had only 16 stores, which contributed to its lack of brand recognition. There was just one store in Seoul, a city of ten million population.

Japan. Japanese customers did not find weekly circulars advertising store specials to be useful. This method is not part of the style of marketing in that country. Walmart's focus on low pricing raises questions among Japanese of the quality of merchandise.

Summary of Findings

Exhibit 3 summarizes findings of the cultural differences that affected the retailer. Our study found that Walmart did not adequately address the four customer Cs of customer solution, cost, convenience, and communication. Ultimately, they had to exit two markets and struggle in others. By properly configuring the marketing mix to local customs and preferences, the outcomes may have been different.

EXHIBIT 3
Summary of Findings

Marketing Mix Strategy	Findings
Place	• Germany – store locations too far from population centers, consumers not willing to travel for small price savings • South Korea – lack of market presence (few stores) against rivals • Japan – joint venture with large local partner helped ease entry; still faces stiff competition from family-owned markets
Product	• Germany – lack of ability to negotiate low prices with suppliers led to inability to compete in obtaining locally sourced products; not able to offer right selection of products • South Korea – encountered entry barriers due to competition to purchase products; rivals prevented supplier partnerships to get low cost/right mix • Japan – complex supplier network difficult to penetrate; limits access
Price	• Germany – consumers very price conscious; strength of existing competitors with already low prices hindered ability to negotiate better prices with suppliers; failed to achieve economies of scale • South Korea – total low cost approach not accepted as consumers prefer overall mix of low cost and luxury items; could not surpass local rivals in purchasing power, which led to higher prices on domestic items; price not necessarily the most important element when compared to preferences in convenience, quality and choice; violated local regulations by offering products below cost on a regular basis • Japan – consumers view low priced merchandise as low quality

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Promotion	• Germany – lack of competitive pricing rendered advertising useless against competitor value pricing and broader product selection • South Korea – erred in using Western-style marketing; failed to cater to consumer preference for eye-catching in-store displays of soft vs. hard goods • Japan – advertising of low prices ineffective due to concerns about quality

In the three countries analyzed – Germany, South Korea and Japan, we found that Walmart's American retail model was not always a good fit and had to be adapted to local factors and conditions mainly after entry had already occurred. Interestingly, even though the company was experienced in international expansion, management did not conduct an adequate assessment of the cultural differences that influence consumer behavior, notably in Germany and South Korea. More in-depth analysis of the customers and cultural norms in these markets would have provided critical insight as to Walmart's readiness to expand here, which may have helped it avoid costly mistakes and political missteps that eventually caused it to exit these two countries.

The difficulties that Walmart encountered in terms of pricing, product variety and advertising showed that it failed to anticipate the differences between the countries and their unique cultures – resulting in an ineffective marketing mix. Because it made little distinction between its U.S. marketing styles versus its approach to international marketing, it was clearly not well positioned to influence buyer behavior, distribution channels and overall sales. While preferring to have the Walmart banner on stores, they have recently taken a balanced approach to international expansion in intervening years through a combination of entry modes, sometimes in collaboration with local partners. The need for cultural adaptation must be emphasized as part of business planning and strategy development for firms to be successful in international expansion.

Questions

1. How do you think it is both an advantage and a disadvantage to be as big as Walmart when entering a foreign market?
2. What were Walmart's assumptions about Germany, South Korea, and Japan that turned out to be wrong? Explain.
3. What mistakes might managers make expanding internationally when applying assumptions based on success in their home country?
4. What modes of entry did Walmart use for expanding internationally? Do you think some modes are more likely to succeed for a huge retail company like Walmart? Explain.

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INTEGRATIVE CASE 3.0
IKEA: Scandinavian Style

"Behind the mountain there are people too." Old Swedish Proverb

As one of the world's most successful businessmen, Ingvar Kamprad never forgot the dreams, aspirations, and hard work of rural people or their ability to find solutions to difficult problems. Growing up on the farmland of southern Sweden, Kamprad embodied many of the traits of the hearty men and women who surrounded him and, as an ambitious working boy, revealed the business traits that contributed to his later success and reputation. As a child, Kamprad learned the concept of serving the needs of ordinary people by purchasing matches in bulk, which he then sold to rural customers at a profit. While still in his teens, he expanded his retail operation to sell everything from pencils to Christmas cards and upgraded the efficiency of his distribution by using the regional milk-delivery system.

Beginnings

In 1943, at age 17, Kamprad formed IKEA with initials representing his first and last names, along with that of the family farm (Elmtaryd) and the nearby village (Agunnaryd). Anticipating the rising consumerism amid the rebuilding boom that followed the war, IKEA moved quickly to provide families with low-cost furniture designs through the convenience of catalogue sales. With the opening of the company's first showroom in 1953, Kamprad created a model of vertical integration, uniting a variety of suppliers under the IKEA umbrella, coordinating long-run production schedules, and controlling distribution. That model expanded in 1964 with the introduction of the first warehouse store, eliminating an entire step in product distribution by allowing warehouse container pick-up by customers.

The business lessons Kamprad mastered as a boy entrepreneur were evidenced at the corporate level in many ways. For example, the bulk purchasing of matches in his youth was a forerunner to the bulk purchase of fabric that expanded upholstery choices for consumers and made the luxury of fabric options, formerly limited to the wealthy, available to all customers. Likewise, IKEA used imaginative distribution and delivery options, such as when an IKEA employee cleverly discovered the company's "flat-box" approach in 1955. While attempting to load a table into a customer's automobile, an employee simply removed the table legs, enabling a new vision of selling furniture unassembled. Practical solutions wedded to a low-cost promise created a new IKEA formula of "knock down" furniture, flat-box storage and shipping, and assembly by consumers armed with IKEA-developed assembly tools and visual instructions. This formula revolutionized the home-furnishings industry.

A major strength of IKEA lies in its pioneering distribution created through unique corporate–supplier relationships. In the earliest days of the company, Swedish fine furniture manufacturers attempted to boycott IKEA and drive it out of business for selling furniture at such low cost. Kamprad out-maneuvered them by forging new partnerships with other Scandinavian manufacturers, providing assurances of long production runs. Moreover, top managers learned that affordable furniture can be provided without the necessity of owning the factories. IKEA is something of a "hollow" or virtual corporation, because nearly all of its manufacturing is outsourced. IKEA uses normal short-term purchasing contracts with suppliers, which means it can quickly adjust orders to changes in demand and not be saddled with huge unsold inventory. Suppliers also are in competition with one another to keep costs low. IKEA has indirect control over suppliers because it often purchases 90 to 100 percent of a supplier's production. Aware of the importance of supplier relationships, IKEA maintains a constant vigilance in working with suppliers to find ways to cut costs while keeping quality standards high, occasionally even agreeing to underwrite supplier technical assistance. That can-do attitude with suppliers has served IKEA well over time.

Supplier Relationships

Today, with 1,300 suppliers in 53 countries, IKEA's integrated design, production, and distribution faces new problems. The sheer numbers can weaken long production runs and disperse supply lines. Global reach also means that domestic requirements vary from one region to another or that certain areas, such as Eastern Europe, have few suppliers capable of high-quality, low-cost production. In addition, furniture competitors have not been idly sitting by but have garnered lessons from the furniture giant. In the face of these challenges, IKEA continues to believe in the power of its ingenuity. Design teams work with suppliers in imaginative ways. For example, the need for expertise in bent-wood design for a popular armchair resulted in a partnership with ski-makers. Likewise, the need throughout Scandinavia for affordable housing resulted in IKEA's expansion into manufactured homes, built on supplier factory floors and

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delivered to construction sites, ready to be filled with IKEA furnishings, conveniently assisted through $500 in IKEA gift certificates to the homeowner.

From the outset, IKEA represented more than catchphrases such as low price and convenience. Looking out for the families with modest incomes leads to IKEA's constant adherence to frugality, which is reflected in a cultural abhorrence for corporate office perks such as special parking or dining facilities. IKEA executives are expected to fly "coach." In his effort to bring "a little bit of Sweden to the world," Kamprad created a lifestyle model that would mold consumer habits and attitudes. True to the rural values of his homeland, Kamprad nurtured the ideal of the *IKEA family*, referring to employees as *co-workers* and bestowing the name *Tillsammans* (Swedish for "Together") on the corporate center.

Mission and Culture

The higher cultural purpose of IKEA was reaffirmed in 1976 with the publication of Kamprad's *Testament of a Furniture Dealer*, which states explicitly that IKEA is about "creating a better everyday life for the majority of people." He went on, "In our line of business, for instance, too many new and beautifully designed products can be afforded by only a small group of better-off people. IKEA's aim is to change this situation." The purpose of providing fine-looking furniture to the masses was to be met via an internal culture that Kamprad described with words such as the following: "informal, cost conscious, humbleness, down to earth, simplicity, will-power, making do, honesty, common sense, facing reality, and enthusiasm." Achieving this purpose meant employees had to have direct personal experience with the needs of the customer majority.

Visualizing the constantly changing needs of a customer base comprised of farmers and college students, young professionals, and on-the-go families, Kamprad defined IKEA's business mission as *"to offer a wide variety of home furnishing items of good design and function at prices so low that the majority of people can afford to buy them."* This is "place-holder" furniture, filling the constantly changing needs in the lives of individuals and families. But the company would go further than merely providing the solution to a consumer's immediate needs. From furniture design to catalogue layout or the arrangement of warehouse showrooms, Kamprad and his co-workers gently imprinted Swedish style and cultural values of home, frugality, and practicality. As CEO Anders Dahlvig explained in a 2005 interview for *Business Week*, "IKEA isn't just about furniture. It's a lifestyle."

That lifestyle is reflected in the consumer shopping experience. The convenience of helpful touches—providing tape measures and pencils, a playroom that frees parents for leisurely shopping, and a restaurant midway through the building to provide a shopping break—is a key part of the IKEA experience. Also familiar is the grey pathway, guiding the shopper along wide aisles through the 300,000-square-foot store. A veritable labyrinth, the route provides the charm of surprise as shoppers venture past the showrooms, or leads to total confusion for those who venture off the intended path. Everything is carefully orchestrated; price tags are draped always to the left of the object, large bins lure with the promise of practical and inexpensive "must-haves," and room arrangements include special touches that spark vision and stimulate add-on purchases.

IKEA's attention to detail is honed through a variety of strategies that link management and co-workers at all levels to their customers. *Antibureaucracy Week* places executives on stock-room and selling floors, tending registers, answering customer queries, or unloading merchandise from trucks. IKEA's *Loyalty Program* and *Home Visits Program* allow company researchers entrance to consumer homes in order to better determine individual and community needs for furniture designs. The results of such efforts can be practical, such as specially designed storage units for urban apartment dwellers or deeper drawers to meet the wardrobe needs of Americans. They can also help in detecting or anticipating cultural shifts. IKEA was the first retailer to acknowledge through its advertising the broadening definition of family to include multi-racial, multi-generational, and single-sex family arrangements and to promote its openness to "all families."

Current Challenges

Over the decades, efforts at strengthening IKEA and consumer family ties and encouraging repeat business as customers moved from one phase of life into another produced a unique global brand famous for innovation. The company's devotion to lifestyle solutions led to rapid movement on two fronts, the expansion of product lines (now over 12,000 products) and the expansion of global markets. By 2019 there were 424 IKEA stores in 52 countries. Global economic woes of recent years—including slumps in world stock markets, rising unemployment, and personal financial insecurity—increased sales and profits for IKEA. As consumers searched for ways to trim overall expenses and cut home-furnishing costs, the company continued experiencing steady growth with a 2018 worldwide sales increase of 4.7 percent, to 38.8 billion Euros.

However, the company's rapid global expansion and the rise of imitators in providing low-cost, quality home furnishings led some critics to believe IKEA had abandoned its maverick methods and relinquished its innovative edge. They detected a loosening of the company's strict core values, established more than half a century ago and reinforced in the training of co-workers in the *IKEA Way*.

Other critics take the opposite view and claim that IKEA is provincial. The problems from this viewpoint are the result of those strict core values, monitored on a regular basis through *Commercial Reviews*, measuring how closely the various stores adhere to the IKEA Way.

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IKEA repeatedly surveys customers, visitors, suppliers, and co-workers about their satisfaction with the IKEA relationship. Repeating the surveys provides clear feedback and even measures important trends, especially if the results venture from the expected 5s toward the dreaded 1s. The critics would argue that the constant pressure for Kamprad's "little bit of Sweden" creates a culture that scorns strategic planning, is slow to react to cultural nuance in new locations, and offers limited opportunity for professional growth or advancement for non-Swedes. They could point out that the notion of *people behind the mountain* should work both ways.

Globalization

Global expansion into non-European markets, including the United States, Japan, and China, magnified the problems and the need for flexibility. Examples abound. The focus on standardization rather than adaptation poses problems for an industry giant such as IKEA, particularly as it enters Asian markets that are culturally different. IKEA's dependence on standardization for everything from store layout to the Swedish names of all products presented translation problems when informing Asian consumers about shopping and shipping procedures. Addressing cultural differences (women are the prime decision makers and purchasers for the home), store and product specifications (e.g., lowering store shelves and adjusting the length of beds), or consumer purchasing power (a worker may need up to a year and a half to purchase a product) was critical to company success in China. Furthermore, IKEA managers realized the need to shift focus from selling furniture to providing home decorating advice when they discovered that many skilled consumers could use the convenient tape measures and pencils to sketch pieces that they could then build for themselves at home.

In the U.S. market, IKEA was slow to make allowances, such as a shift from measuring in meters to feet and inches. While consumers embraced low pricing and the convenience of break-down furniture, the company's delay in bed size designation to the familiar king, queen, and twin drove U.S. customers bonkers because "160 centimeters" meant nothing to them. Co-worker issues also arose. Angry American workers in locations such as Danville, Virginia, moved to unionize amid complaints of discrepancies in pay ($8.00 per hour compared to the $19.00 per hour for workers in Sweden), vacation (12 days annually for U.S. workers compared to five weeks for their counterparts in Sweden), and the constant demands by strict managers in requiring, for example, mandatory overtime.

Officials with IKEA admit they "almost blew it" in America and that they are committed to being both global and local. They insist they are responsive to issues and people. The company points to a history of standing against corruption and to its own quick response when a subcontractor's bribery efforts brought the hint of scandal to IKEA's door. Management proudly points to the company's recent record in looking out for the needs of ordinary people through charitable projects such as IKEA Social Initiatives, benefiting over 100 million children. Service to people "behind the mountain" also requires acknowledgement of the mountain. IKEA places a priority on sustainability, working to improve company energy efficiency as reflective of its commitment to thrift, the wise use of natural resources, and a family-level regard for stewardship of the earth. From the elimination of wood pallets and the ban on use of plastic bags to the installation of solar panels and the phasing out of sales of incandescent light bulbs, IKEA leads consumers and competitors by example and demonstration of its core values.

Behind the Curtain

Despite the concerns of critics, those values established by Kamprad remain intact through the combination of co-worker training in the IKEA Way and a carefully crafted organization structure that leaves little room for cultural or corporate change. Following his retirement in 1986, Kamprad remained senior advisor on a board dominated by fellow Swedes. Organization structure resembles the IKEA flat box, with only four layers separating the CEO and the cashier on the sales floor.

Historically, financial details about IKEA have been kept tight and neat and, until recently, secretive. The full public disclosure of information such as sales, profits, assets, and liabilities appeared for the first time in 2010 on the heels of a Swedish documentary. The ability to maintain such an opaque organization dates back 30 years. The year 1982 marked the transfer of IKEA ownership to INGKA Holding, held by Stichting INGKA Foundation (a Dutch nonprofit with Kamprad chairing the foundation's five-member executive committee). The IKEA trademark is owned by IKEA Systems, another private Dutch company whose parent, IKEA Holding, is registered in Luxembourg and owned by Interogo, a Liechtenstein foundation controlled by the Kamprad family. This complex organizational set-up enabled IKEA to minimize taxes, avoid disclosure, and through strict guidelines, protect Kamprad's vision while minimizing the potential for takeover.

The Future and India

The vision remains, but with global expansion IKEA's corporate culture ventured into ways to use technology to bond loyal IKEA customers while tapping into their ideas and valuable feedback. The company expanded its e-commerce sales and initiated the *IKEA Family Club* in order to strengthen ties with existing customers and build long-term relationships. Family club members assist in sharing values and ideas and providing co-creating value for everything from product development to improvements in stores and service. Members are encouraged to increase their visits to stores, on-site "experience rooms," and the

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website to familiarize themselves with products and to build ties of shared-development in finding real-life solutions to the home-furnishings challenges they encounter at various stages of their lives. This latest development in the long history of IKEA reinforces the decades-old goal of the founder to continue to look behind the mountain to meet the needs of ordinary people.

There have been increasing hints of potential change. In the years immediately preceding and since the death of Kamprad (January 2018), chinks have appeared in the cultural armor. With expanded globalization, devotion to Kamprad's notion of "a little bit of Sweden" only highlights the problems with cultural nuances and continued limited opportunities for non-Swedes to professional advancement. Some cultures balk at embracing the company notions of a flattened organizational hierarchy or domestic partner benefits. There have been other push-backs. Workers in the United States, Ireland, and Portugal accuse the company of heavy-handed pressure against the formation of unions, complaining of "scare tactics," while official complaints from organizations including the international UNI Global Union have been filed with the Dutch government and the OECD (Organization for Economic Cooperation and Development).

Across traditional "safe market" areas, such as the United States, the rise of competitors such as Wayfair, Amazon, and even Walmart have begun nicking away at IKEA's hold on consumer flat box shipping with e-market convenience. Some promising markets have seemed almost impenetrable. For example, on the Asian front, IKEA's first effort in Japan failed in 1986, and it took 20 years for a return to that market.

INGKA boss and IKEA Systems board member Anders Dahlvig floated the notion a few years ago of a separation of INGKA into North American, European, and Asian companies to better manage the distinct business challenges and cultural nuances of each market. At that time, the idea was not adopted, but the death of Kamprad brought what seemed to be a flurry of changes in an organization whose devotion to tradition had served it well. The company balanced the slashing of 7,500 jobs (mostly office personnel) with a new focus on digital development and the potential for over 11,000 jobs worldwide. Building upon environmental realities and plans initiated before the death of the founder, an additional move was the beginning of expansion away from the suburbs with a planned 30 new stores in city centers.

Another strategic area for future development remains IKEA's Asian market. India in particular offers incredible possibilities with its rapidly growing middle class. A rise in education and income among the young (almost half of the nation's 1.3 billion people are under the age of 25) bodes well for the household needs of apartment dwellers and starter homes in search of low cost, quality furnishings. One IKEA executive says plainly, "India is an opportunity to make the next 75 years of IKEA."

Regulations to limit foreign investment in Indian retail squelched IKEA's initial entrance plans in 2007. Falling back to regroup, IKEA poured six years into planning for the opening of stores in Hyderabad (August 2018) and Mumbai (2019) with more than 1,000 home visits to assess the furnishing needs of the population, special training for Indian employees, and a scramble to find quality suppliers to meet Indian government requirements that one-third of store merchandise be acquired locally.

The question remains whether IKEA's careful planning can meet the special challenges of the Indian market. The company acknowledges the need for igniting both consumer interest in the IKEA store concept and experience and a strong online presence in a culture that (with the exception of large and popular shopping malls) shows preference for small, trusted shops over big-box stores; where consumers may use catalog images and the convenience of those IKEA tape measures to provide replica requests to local carpenters; where traffic chaos and a clear preference for the Metro or the easy navigation of motorcycles by young professionals makes flat-box pickup of many items difficult; and where traditional home furnishing needs and a taste for Indian teak over what locals imagine as "inferior plywood and plastic" requires a concerted effort to push the quality of IKEA products.

The future will tell whether Kamprad's vision can be united with India's cultural realities and unlimited future potential, and whether it is time for IKEA to revisit the notion of Dahlvig's separation of INGKA into three units to address the special needs and business environmental challenges of each global region.

Questions

1. Evaluate IKEA's approach to entering India. What do you think IKEA learned from its previous experiences with international expansion to guide its entry into India?
2. Describe IKEA's unique culture. Do you think it should try to maintain the same strong culture values while expanding globally? Explain.
3. How would you describe IKEA's approach to organization design?
4. How does IKEA stay innovative? Do you think its approach to innovation is related to its culture or structure? Explain.

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INTEGRATIVE CASE 4.0

Engro Chemical Pakistan Limited—Restructuring the Marketing Division*

CASE 4.0

In November 2008, Khalid Mir, General Manager Marketing at Engro Chemical, a fertilizer company in Pakistan, was looking at the results of an internal survey to ascertain how well the newly implemented sales structure was functioning. The company had undertaken a restructuring of the marketing division to retain mid-level employees and to become more customer focused.

Feedback from multiple sources about the new structure had flagged a number of issues, which included (1) the need for development of new competencies and further revision of standard operating procedures to prepare employees to handle changes in their tasks; (2) the fear and anxiety of employees losing their authority and power; (3) the confusion resulting from new reporting relationships, especially relating to the support functions; (4) the Tier IV syndrome, which referred to the uncertainty and dissatisfaction among Tier IV officers regarding their upward mobility; and (5) the lack of coordination with other divisions of the company about the restructuring of the marketing division.

Now, Mir was contemplating his next steps. Should he fine-tune the new structure or was another round of restructuring imperative? What other steps were essential to realize the full potential of the marketing division?

Company Background

Engro Chemical Pakistan Limited was established in 1965 under the name Esso Chemical Pakistan Limited, which was later changed to Exxon Chemical Pakistan Limited in 1978 and eventually Engro[1] Chemical Pakistan Limited (ECPL) in 1991, when Exxon divested its fertilizer business worldwide. (Exhibit 1 details Engro's historical timeline.) Engro Chemical Pakistan Limited was a major competitor in Pakistan's fertilizer market and the second largest producer of urea in Pakistan with a total production capacity of 975,000 tons per annum, approximately 19 percent of the total domestic production capacity. It was also a market leader in blended fertilizers (NPK), with an annual production capacity of 160,000 tons and was involved in imported phosphate fertilizers. Engro had also successfully diversified into various other sectors through new projects, joint ventures, acquisitions, and mergers (see Exhibit 2 for a list of Engro's subsidiaries).

ECPL's main production facility was located at Daharki in upper Sindh, near the Mari gas fields. This plant had increased its production capacity nearly six-fold since its inception. The latest expansion plan, which would be operative in the year 2009, would increase production by another 1.3 million tons. This $1 billion project was estimated to bring Engro's share of total domestic production capacity up to 32 percent.

Culture

Engro Chemical was committed to supporting its culture through policies and administrative frameworks that promoted open communication, maintained employee and partner privacy, and assured employee health and safety. Over 700 employees brought their expertise and dedication to the workplace.

According to Mir:

All employees are valued and their inputs and views are given significance, which builds a friendly environment within the organization, independent of any barriers in communication.

Such an open environment had a positive impact on employee morale and their willingness to continue working in the organization. Engro's safety, health, and environmental responsibilities extended beyond protection and enhancement of its own facilities and included the distribution, use, and disposal of its products as well.[2]

A significant change could be seen in the culture since 1991 when Exxon divested its fertilizer operations and the company was named Engro Chemical Pakistan Limited.

*This case study was written by Professor Anwar Khurshid at Lahore University of Management Sciences and Muddassir Shafique Chaudary to serve as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Research assistance was provided by Mehwish Ibrahim and Salman Humayoun. This material may not be quoted, photocopied, or reproduced in any form without the prior written consent of the Lahore University of Management Sciences.

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[1]Engro is an acronym for Energy for Growth.

[2]For more information about Engro visit www.engro.com.

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EXHIBIT 1

Historical Timeline up to 2003

- **1957** Search for oil by Pak Stanvac, an Esso/Mobil joint venture, led to the discovery of Mari gas field situated near Daharki, a small town in upper Sindh province. Esso was the first to study this development in detail and propose the establishment of a urea plant in that area.
- **1964–1965** The proposal was approved by the government and led to a fertilizer plant agreement signed in December 1964. The Esso Pakistan Fertilizer Company Limited was incorporated, with 75 percent of the shares owned by Esso and 25 percent by the general public of Pakistan. Soon, a land area of 500 acres was selected for the plant site at Daharki.
- **1966** The construction of a urea plant was started with the annual capacity of 173,000 tons.
- **1968** The construction of a urea plant was completed and commissioned at a cost of US$ 43 million. A fully-fledged marketing organization was established and given the important task of effective marketing and commencing agronomic programs to educate the farmers of Pakistan. As a result of these efforts, not only did the consumption of fertilizers greatly increase in Pakistan but also the company launched its own branded urea, Engro.
- **1978** As part of an international name change program, Esso became Exxon and the company was renamed Exxon Chemical Pakistan Limited. The company continued to prosper as it relentlessly pursued productivity gains and strived to attain professional excellence.
- **1990** The plant capacity was expanded in low cost steps to 268,000 tons.
- **1991** Exxon divested its fertilizer businesses worldwide, deciding to sell a 75 percent share of the company's equity. The company underwent an employee-led buy-out, the first in the corporate history of Pakistan. Engro came into existence in 1991.
- **1993** The Pakven Project was launched, to increase the company's capacity by more than double, that is, to 600,000 tons. This also helped to relocate urea/ammonia plants from the United Kingdom and the United States, with an investment of US$ 130 million. The prime minister of Pakistan inaugurated the expansion. The company celebrated the silver jubilee of its operation.
- **1995** Plant capacity was further increased to 750,000 tons per annum with an investment of US$ 23 million. Engro entered into its first 50/50 joint venture, with Royal Vopak of Netherlands, to form and build a fully integrated state-of-the-art jetty and bulk liquid chemical and LPG storage facility at a cost of US$ 65 million.
- **1996** The company successfully engineered and implemented an expansion program that gave a major boost to the urea production and its capacity increased to 850,000 tons per annum.
- **1997** On October 10, Engro entered into its second 50/50 joint venture, called Engro Asahi Polymer & Chemical Limited (EAPCL) Company, in collaboration with Asahi Glass Company and Mitsubishi Corporation of Japan to build the first world-scale PVC resin manufacturing facility at a cost of US$ 80 million.
- **1998** Another innovative and modernization project, called Energy Conservation and Expansion Strep (ECES-850), was successfully implemented. The project was constructed at a cost of US$72 million and had increased Engro's annual urea production capacity from 750,000 to 850,000 tons. On May 2, the prime minister of Pakistan formally inaugurated Engro Vopak Terminal Limited (EVTL).
- **1999** On March 9, the prime minister of Pakistan formally inaugurated the 850 KT expansion project at the Daharki urea plant. Workshops of the Daharki urea plant received ISO 9002 certification.
- **2000** On February 9, General Pervez Musharraf, the chief executive of Pakistan, inaugurated Engro Asahi Polymer & Chemical's PVC resin manufacturing plant at Port Qasim.
- **2001** On July 26, Engro mourned the death of its chairman, Shaukat Raza Mirza.
- **2002** On August 9, Engro's NPK fertilizer plant at Port Qasim was inaugurated by two federal ministers. On October 9, Engro signed an MoU with Oman Oil Company to build an ammonia urea fertilizer complex in Oman.
- **2003** On April 28, Engro acquired controlling interest in the Automation & Control Division of Innovative Private Limited (INET) (www.innovative-pk.com/automation), a Lahore-based technology company. The new company is called Innovative Automation & Engineering (Private) Limited, headquartered in Lahore.

Source: Company documents.

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EXHIBIT 2
Subsidiaries of Engro

Over the years, Engro has successfully diversified its business into various related fields as well as a recent venture into a FMCG line:

- Engro Vopak Terminal Limited (EVTL)
- Engro Polymer & Chemical Limited (EPCL)
- AVANCEON (formerly Engro Innovative Automation & Engineering [Private] Limited)
- Engro Foods Limited (EFL)
- Engro Energy Limited (EEL)

Source: Company documents.

Nasir Iqbal, National Sales Manager (NSM) in 2008, recalled:

From a bureaucratic and rigid structure, the company has moved on to become a workplace where challenges to the status quo are encouraged and new ideas are generated, nurtured and developed, something which was lacking under the Exxon management.

Moreover, the dignity and self-esteem of the people were highly valued. Everyone in the workplace was consistently treated with respect and a joint effort was observed to create an organizational environment in which individuals were encouraged and empowered to contribute, grow, and develop themselves and their colleagues.

Need for Restructuring

Toward the beginning of 2008, Mir discovered through internal feedback from the sales teams and field offices that Engro Chemical had begun to face major problems relating to employee turnover, inventory control, low market development, and suboptimal merchandising efforts in its original marketing-division structure. Hence, in March 2008, Mir took it upon himself to convince the upper management about the dire need for Engro Chemical to undertake a restructuring initiative of its entire marketing division in order to work on these areas. The major focus of this restructuring was personnel and customer driven—a majority of the previous Tier III[3] salesforce were promoted to area marketing managers, new Tier IV-level sales personnel were hired, and the number of personnel working on market development and merchandising efforts was increased.

Original Structure of the Marketing Division

Originally, Engro Chemical had divided Pakistan into six sales regions with one regional manager (RM) responsible for each region. Exhibit 3 presents the original structure of the marketing division. The regional managers reported directly to the national sales manager who in turn reported directly to the general manager agribusiness. The regions were further divided into various districts; each district had one sales officer (SO), and there was one technical services officer (TSO) for every two or three districts. Each region also had one distribution officer (DO) and several warehouse in-charge officers.[4]

At ECPL, the criterion for selection of sales officers was an MBA from a respected institution for the various positions in the field. The graduate was then gradually promoted over a stretch of five years, after which the designation of senior sales officer was received. Based on the level of performance, a senior sales officer was eventually promoted to one of the regional manager positions in approximately four to six years.

The sales officer was responsible for meeting sales objectives, cost controls, and profit maximization through collaboration with the technical services officer and distribution officer. The latter in turn was responsible for inventory control and warehousing in the entire region and ensured a smooth flow of supply to meet regional demand. The TSO was responsible for conducting market development activities through meetings with farmers and educating them on agronomic information and fertilizer usage.

Problems with the Original Setup

When Mir sat down with Nasir Iqbal in an informal meeting to discuss the restructuring process, they realized that there were three main reasons why the original structure needed to be changed.

High Employee Turnover

When the company evaluated current and previous employees through surveys and face-to-face interviews, it was discovered that there was a low level of job satisfaction in Tier III of the organizational structure, specifically among MBA sales officers. The main cause for this was a mismatch between the job content and employee skill levels. The sales

[3]Engro's marketing division is structured according to different hierarchical levels called *tiers*, where each of its five tiers comes with a different status, responsibility, and compensation within the organization.

[4]The officers were a mix of MBAs and agriculture graduates, with the majority of the workforce comprising the latter.

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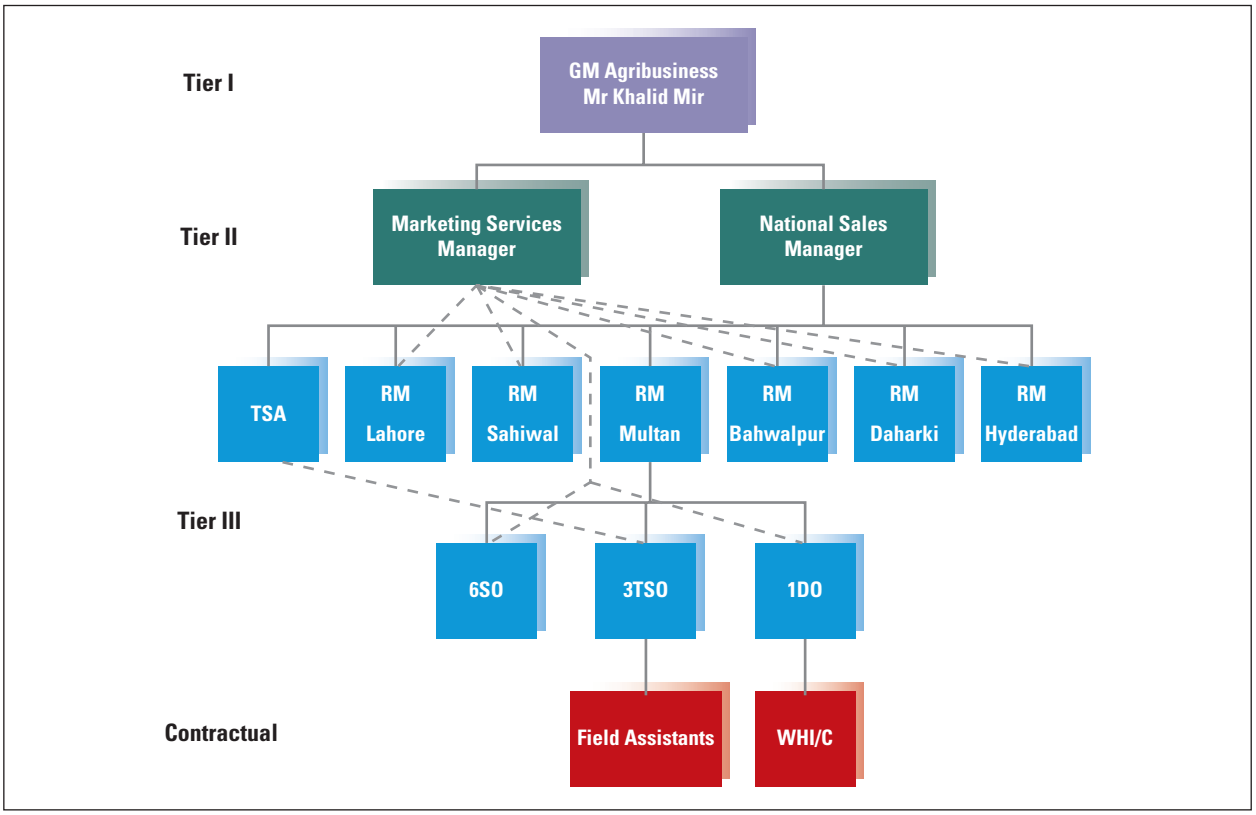
EXHIBIT 3
Original Structure of the Marketing Division



Source: Company documents.

job required long hours of travelling and relocation to distant rural areas of Pakistan; there was no supervisory role and very little managerial application. Furthermore, the promotions in the first five years were solely salary based; there was no improvement in fringe benefits and no addition to job content.

In contrast, the MBA graduates being hired were highly ambitious individuals, with a high need for achievement.

Mir realized that:

Employees would lose motivation in three years or less and there was a general feeling of underemployment, which naturally led to dissatisfaction and high turnover.

An additional external factor that contributed to the high turnover rate was the better opportunities that existed in the FMCG (Fast Moving Consumer Goods) and financial sectors of the country's urban areas.

Weak Market Development

The limited number of TSOs for each region resulted in long travel times for TSOs. Some TSOs reported spending almost 50 percent of their time travelling; as a result, their efforts in market development activities and activity-to-time ratios were significantly lower than optimal. This meant that the tasks that were envisioned for the TSOs were not being carried out in all districts.

Inventory Control

The distribution officer's primary responsibility included physical audit of warehouses' inventory. Taking the example of the Multan region, it was seen that one distribution officer had to visit 16 warehouses spread throughout the region per month; this translated into each warehouse being visited only once a month or less. As a result, inventory control was not as efficient as it should have been.

The Change Process

Faced with such difficulties like low morale, high employee turnover, and ineffective market development of new products, there was a general realization by the management that something needed to be done. After conducting a few exit interviews with MBAs leaving the organization, Mir realized that the old structure needed to be changed. One of the sales officers he interviewed claimed that, "in FMCG companies, young MBA graduates like me are given more opportunity in terms of job scope and job status. This is something that is lacking in the current Sales Officer position at Engro."

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Mir began to consult experts and held several meetings to discuss his ideas about ways to tackle these problems. He met with Nasir Iqbal, National Sales Manager at the time, and they both agreed that the matter was critical in nature because the dearth of MBAs in the organizational hierarchy meant that there was a diminishing pool for future senior management. Also, the Zarkhez Rejuvenation Study[5] that was conducted during this period highlighted the need for Engro to better connect with its customers. One of the consultants that Mir met during the change process advised him to adopt an eight-step model[6] to lead the change initiative at Engro. Mir decided to move fast by creating a sense of urgency for bringing about this change.

He held meetings with RMs, the marketing services manager (MSM), and the NSM to form powerful guiding coalitions. He shared his vision of "revamping the rigid fertilizer sales structure to make it more flexible and capable of meeting the needs of its employees and customers" with the top management and sought their feedback. It was found that everyone was in favor of the restructuring. Buy-in from other employees was gained through a series of meetings. Mir held a meeting in each region and shared with the employees his vision of the new structure. In addition, regular notifications and announcements were sent out to the field offices to keep them updated with the changes.

The initial plans were drafted and presented in all the regions to all permanent employees. In the plan, Mir communicated his vision and discussed the benefits of the new structure and addressed any reservations people might have toward the restructuring. It was also the desire and objective of the management that no employee would be laid off during the change process and that a smooth transition would take place into the new structure. These intentions were clearly communicated to all the employees.

Once the management's vision was conveyed to the regions, it was necessary to ensure that all employees were onboard with the decision and that little resistance would be met during the change process. In collaboration with the other support divisions, including accounting, finance, and IT, a special task force consisting of senior employees was set up to develop new processes according to the revised structure and roles. A Limits of Authority manual was also prepared in conjunction with the zonal offices and the head office, which outlined the basic changes in reporting lines and authority of all members.

Implementation

In March 2008, Engro Chemical went ahead with the restructuring of the marketing division. The first step was the dissolution of the previous sales regions and the formation of three zones; Lahore and Sahiwal regions became the North Zone, Multan and Bahawalpur regions became the Central Zone, and Daharki and Hyderabad regions became the South Zone. (See Exhibit 4 for a map of Engro's territories.) The sales districts were then grouped into 23 areas based on sales volumes; smaller districts were merged into one area, whereas large districts became areas of the same name. For example, small sales districts like Multan and Muzaffargarh became the Multan Area and large sales districts like Dera Ghazi Khan became the Dera Ghazi Khan Area. Area offices were designed to be located in the sales districts with greater sales volume so as to allow the area marketing managers (AMMs) to effectively address their sales responsibilities. (Exhibit 5 shows the new structure for the marketing division.) It was anticipated that this new structure would be able to compete better against Engro's main and biggest competitor, Fauji Fertilizer (FFC). Exhibit 6 presents FFC's probable sales structure based on market intelligence and can be used for comparison to Engro's structure.

In terms of manpower, a zonal marketing manager (ZMM) was in charge of each zone. The hierarchical level for this designation was equivalent to the NSM in the old organizational structure. The three ZMMs reported directly to the GM marketing. The ZMMs consisted of the previous NSM and the two experienced regional managers from the previous setup. New positions for the remaining regional managers were created at the head office in Karachi.

The top performing SOs and TSOs from the previous structure were promoted to area marketing managers. Each of the new areas was headed by an AMM who was responsible for meeting sales targets and market development and distribution in their area. Effectively, their role was equivalent to that of the regional managers from the previous setup but with a smaller geographical and market spread. Each district had one sales officer and one market development officer (MDO) (replacement of the technical services officer)[7] In addition, each area had one distribution and merchandising officer (D&MO) (replacement of the distribution officer). Quantitatively, this meant that there were approximately 87 percent more man-hours on market development and 110 percent more on distribution and warehousing.

The D&MO was also responsible for merchandising activities in his area. In the previous setup, there was no specific officer assigned for monitoring and carrying out merchandising activities. As a result, most material was left at dealer stores without proper display or follow-up. The D&MO's responsibilities also included visiting dealer outlets and providing them with merchandising material at the correct time as well as ensuring proper display of the material and products.

[5]The Zarkhez Rejuvenation Study was conducted for one of Engro's leading NPK brands, Zarkhez, to gauge how well the brand was performing. Zarkhez is used in Urdu, the national language of Pakistan, to mean "fertile."

[6]John P. Kotter, "Leading Change—Why Transformation Efforts Fail," *Harvard Business Review*, March–April 1995.

[7]In a few districts where sales volume was very low, only a sales and market development officer (S&MDO) was employed. They were usually agronomists with experience in sales and marketing as well. In the previous setup, they were referred to as STOs, that is, sales and technical officers.

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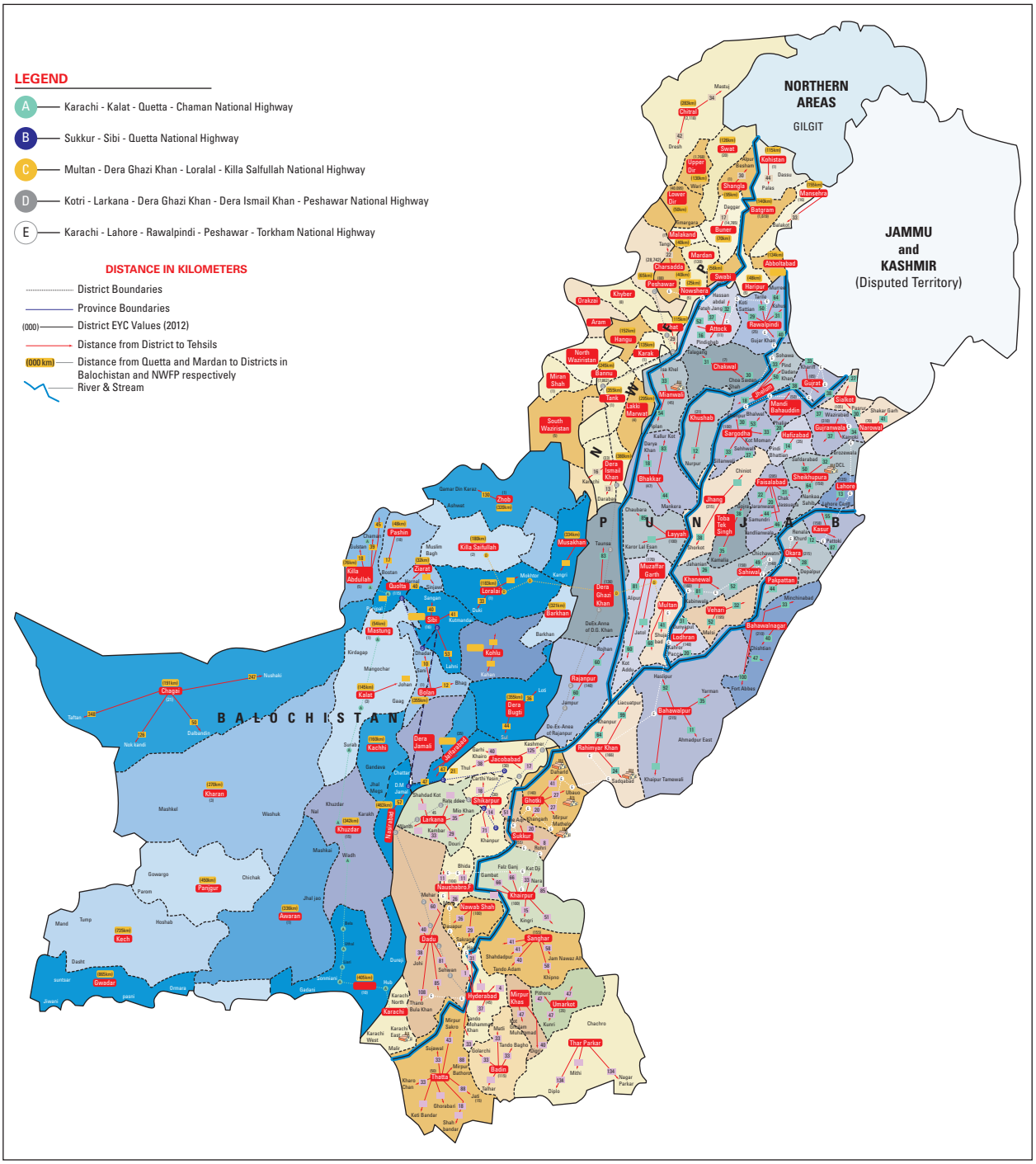
EXHIBIT 4

Map of Engro's Territories in Pakistan


LEGEND
A Karachi - Kalat - Quetta - Chaman National Highway
B Sukkur - Sibi - Quetta National Highway
C Multan - Dera Ghazi Khan - Loralai - Killa Salfullah National Highway
D Kotri - Larkana - Dera Ghazi Khan - Dera Ismail Khan - Peshawar National Highway
E Karachi - Lahore - Rawalpindi - Peshawar - Torkham National Highway
DISTANCE IN KILOMETERS
District Boundaries
Province Boundaries
(000) District EYC Values (2012)
Distance from District to Tehsils
(000 km) Distance from Quetta and Mardan to Districts in Balochistan and NWFP respectively
River & Stream
NORTHERN AREAS
GILGIT
JAMMU and KASHMIR
(Disputed Territory)
BALOCHISTAN
PUNJAB
N.W.F.P.

Source: Company documents.

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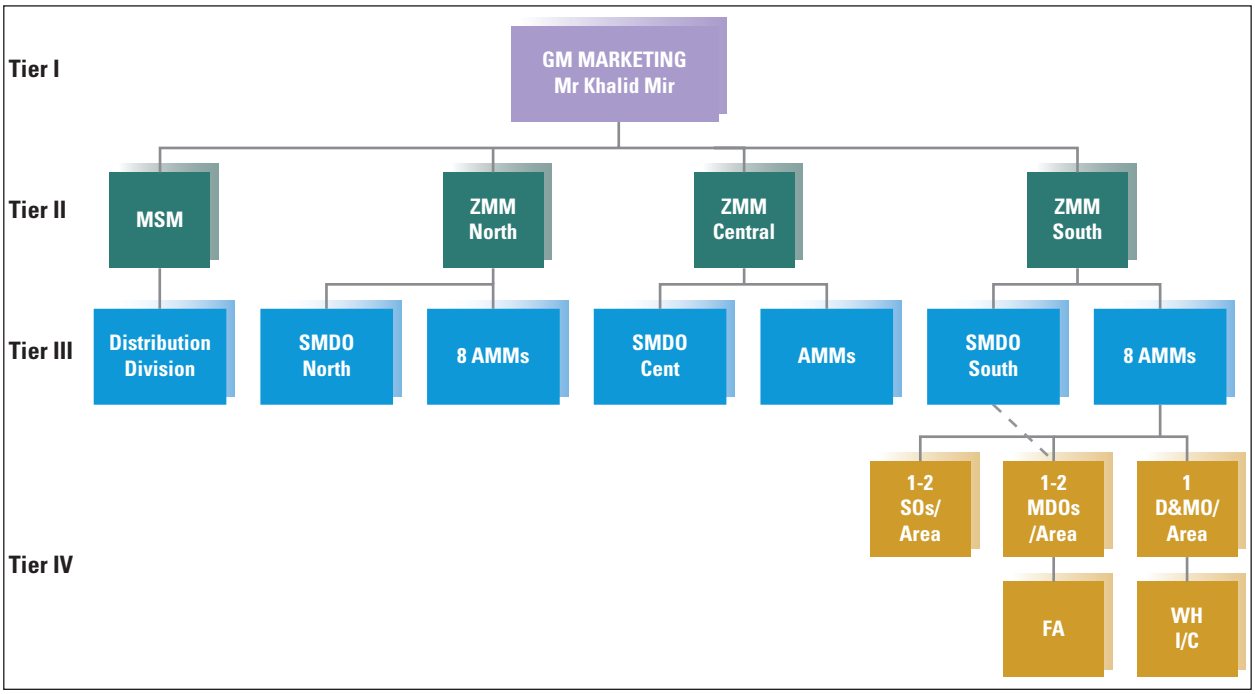
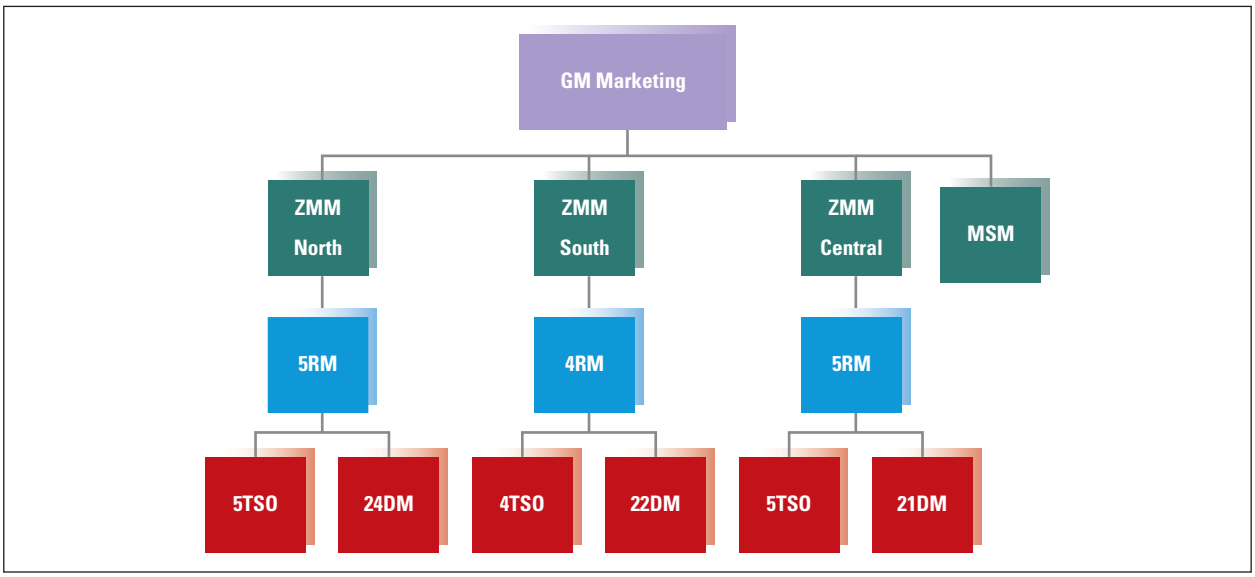
EXHIBIT 5
Restructured Marketing Division



Source: Company documents.

EXHIBIT 6
Leading Competitor's Sales Force Structure



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Another replacement was the designation of a senior market development officer (SMDO)[8] equivalent to the technical services advisor (TSA) of the previous setup. Each zone had one SMDO who, in the absence of the ZMM, was in charge of their respective zones. The SMDO was also responsible for the overall strategy development and execution of market development activities in areas in collaboration with AMMs and MDOs. Each zone had one SMDO who reported to the ZMM.

AMMs, under the new structure, were responsible for handling key accounts per the 80:20 principle, where the top 20 percent of the customers that resulted in 80 percent of Engro's sales were given the utmost priority. It was the top management's vision to incorporate this principle into the new structure, thus improving customer relations. This had helped to improve the company's reputation in the market.

In the months following March, monthly marketing meetings (MMM) were held in order to ensure that the restructuring proceeded per schedule. ZMMs, MSM, HSE coordinator, and marketing coordinator were the core members of this meeting under the chairmanship of GM marketing. Critical issues and areas of improvement were highlighted during these meetings and matters such as hiring of personnel and funding issues were discussed. The role of HSE under the new structure was examined and it was made sure that it was given precedence. Moreover, people were at the heart of all initiatives at Engro, so management was extremely concerned about whether or not they were adjusting into the new structure, and this matter was discussed at length during these meetings.

In order to measure the success of the new structure, some performance indicators were identified. The Zarkhez Tracking System was established to measure the improvement in sales for one of Engro's leading brands, Zarkhez. Through this system, farmer sales were tracked and monitored to assess their satisfaction with the newly launched product. Follow-up interviews were conducted to determine whether or not farmers were content with the product and this helped build loyalty for Zarkhez in the market.

Following restructuring, Annual Zonal Conferences were established for the first time to acknowledge top performing Tier IV officers. All zonal employees of Tier II, III, and IV attended this conference apart from head office delegates. This conference provided them with an opportunity to meet the marketing management at least once a year. The first International Marketing Conference (MARCON) was held in Bangkok. Previously, MARCON was held within the country, so having it at a foreign location improved the prestige of all those attending it, including the newly promoted AMMs. The theme of the conference was "Engaging the Leader in You" and it was held with the specific intent of giving importance to the newly promoted AMMs and their role in helping to achieve Engro's sales objectives.

Improvements

Mir assembled a functional team of four individuals under the leadership of a marketing coordinator to conduct an audit to analyze how well the new structure was operating. Some marked improvements could be seen as a result of the restructuring.

Increased Communication Among Employees

Dealers and employees both commented on the ease with which they could resolve their grievances after the restructuring. In the previous structure, there was one regional manager for each of the six regions (Hyderabad, Daharki, Bahawalpur, Multan, Sahiwal, and Lahore) who was accountable for administrating sales in all the areas pertaining to his/her region. In this way, a regional manager in Daharki would also have to deal with the sales officers and dealers in Quetta, which resulted in a communication gap between the regional managers and the field representatives. In the new structure, a new managerial seat of an AMM was added, and these AMMs were designated to all 23 areas of the sales districts. Having a managerial representative in each area eliminated the delay in resolving grievances between the customers, field force, and top management.

Efficient Inventory Control

There was one DO for each region in the previous setup, who was responsible for all the inventory checks and audits pertaining to that region.

As Mir revealed:

It was impossible for one distribution officer to cover all the districts and warehouses and the inefficiency had become apparent to all through quarterly inventory audits that were conducted within the company.

To counter this, the DOs were replaced by D&MOs in every area, who were now able to visit and audit a warehouse more often, marking a significant increase in efficiency of inventory audits. Similarly, the safety audits also tended to become more efficient in the new salesforce setup as there was now one AMM for each area responsible for the safety audits in the warehouses of that particular area.

Greater Market Penetration and Exposure

Further efforts were effectively being put into market development and merchandising. With one MDO in every district and one D&MO in every area, greater market penetration in terms of market development and merchandising was ensured. The registered results of these activities included a significant rise in farmer awareness, trial purchases, and dealer satisfaction with merchandising display since the change in the marketing structure.

[8]Not to be confused with S&MDO, sales and market development officer.

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Greater Job Satisfaction of Tier III Employees in Their New Role as AMMs

The MBA graduates hired as AMMs seemed to be more satisfied with the new setup and the overall restructuring effort. In the previous structure, a newly graduated MBA would be hired as an SO and after gathering an average experience of about four to five years in the field, he or she would be promoted to a management position in the regional office as an RM. However, in the new structure, a newly graduated MBA was hired as an AMM and after two years in the field, he or she could be promoted to a management-oriented job at the head office. This change in the structure was observed to provide greater job satisfaction among the Tier III MBA employees.[9]

Quantitative Analysis

The audit team that was initially sanctioned by Mir conducted a quantitative analysis of the restructuring, which revealed that in terms of the change in manpower, there had been a significant increase in the efforts of the company in market development and distribution activities. (Detailed information on the quantitative changes in manning is presented in Exhibits 7 and 8.)

There had been a 44 percent increase in total man-hours, which would go up to 58 percent when all positions would be filled per management's original plan. This translated into an increase of 248 and 328 hours, respectively. Among the four main functions, man-hours in market development had increased by 116 hours and in distribution by 72 hours. In the new structure, it was seen that at least 74 hours were dedicated to merchandising activities.

Management was quick to realize, however, that this analysis was simplistic in nature since it assumed an eight-hour workday for employees, whereas in reality, field staff spent a variable amount per day, which also included travelling time. Additionally, overtime had not been accounted for. Another imperfection in this analysis was that it did not account for follow-up sales calls conducted by MDOs after a market development activity or by D&MOs after setting up merchandising material. Furthermore, per the discretion of the AMM, employees were engaged in different functions at different times. The AMM was at liberty to utilize his entire area team for sales activities one day and for market development the next. Thus, the figures presenting the analysis in Exhibit 7 were an approximation, albeit one that was determined through interviews with relevant personnel.

Concerns and Challenges

Although there were numerous concerns identified related to the restructuring, the management believed that a lot of these were interrelated. After conducting feedback interviews with employees who were a part of the restructuring process and reviewing the restructuring audit report, Mir identified certain areas for improvement.

In the previous structure, all officials were aware of the procedures pertaining to their job or tasks. For instance, a sales officer was handed out a ready manual of standard operating procedures (SOPs) on the first day of his job. With the restructuring of the marketing division and a fresh flow of newly graduated, inexperienced officials being employed, it was observed that the SOPs needed to be revised keeping in view the change in employees' responsibilities and tasks. By the end of 2008, SOPs in relation to sales had been revised, whereas SOPs in relation to market development, merchandising, and distribution were still in the process of being revised.

Likewise, with the reorganization of tasks and jobs among the employees, it was observed that people were relatively unaware of or confused about the reporting lines, specifically with regard to support functions. For instance, when an SO in the old structure had to report a delay in the distribution of materials or goods, he could report it to the DO. However, in the new structure, the AMM, who replaced the SO, initially found it hard to determine whom to report to in terms of issues concerning distribution.

An AMM, who had only been involved in sales in the past, needed some exposure to the specifics of distribution, merchandising, and market development. Moreover, the lack of resources, knowledge, and training of the new SOs at Tier IV resulted in a delayed response to fulfilling dealer requests. This resulted in the reduced standard of SOs in terms of etiquette and confidence, while the delayed response to dealers' statement requests disrupted the flow of information, especially the Engro product dealer transfer price. Hence, market development and distribution network needed to be improved further. These responses were a result of the inadequate training and orientation of officers as compared to the previous structure and the breakdown of communication with officers in the field.

It was also seen that during restructuring, there was little effort made to deal with the anxiety and disorientation of people losing their authority and power in the new structure. For instance, the future roles of the existing national sales manager, regional managers, or Tier III (non-AMM) officers were not properly defined. Mir realized that senior management should have recognized each individual's contribution in the organization so far and highlighted the need for the change in structure. There was also a slight feeling of annoyance observed among the Tier III employees who did not make their mark to the AMM position at being equivalent in designation to Tier IV personnel, that is, a fresh-graduate Tier IV hire was an SO, a D&MO, or an MDO and a Tier III non-AMM employee of five years' experience was also an SO, a D&MO, or an MDO.

[9]It should be noted that this aspect had also drawn critique from very senior members of the company who felt that early and rapid promotions would not prepare a person adequately for the top management slots.

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EXHIBIT 7

Quantitative Changes in Manning

Note: S&MDOs are individuals performing both SO and MDO responsibilities in smaller areas.

			ACTIVITY (% OF TIME SPENT)						TIER WISE CHANGES	
		Designation	NUMBER OF PERSONNEL	NUMBER OF MAN HOURS	Sales	Market development	Distribution	Merchandising	NUMBER OF PERSONNEL	NUMBER OF MAN HOURS
OLD STRUCTURE	TIER II	NSM	1	8	100%	0%	0%	0%	2	16
		TSA	1	8	0%	100%	0%	0%		
	TIER III	RM	6	48	70%	15%	15%	0%	69	552
		SO	30	240	100%	0%	0%	0%		
		TSO	18	144	0%	100%	0%	0%		
		DO	7	56	0%	0%	100%	0%		
		STO	8	64	50%	50%	0%	0%		
	TIER IV	N/A							N/A	N/A
TOTAL MAN HOURS				**568**	**313.6**	**191.2**	**63.2**	**0**		
NEW STRUCTURE	TIER II	ZMM	3	24	40%	40%	20%	0%	3	24
	TIER III	SMDO	3	24	10%	75%	10%	5%	40	320
		AMM	23	184	65%	25%	10%	0%		
		SO	5	40	100%	0%	0%	0%		
		MDO	7	56	0%	100%	0%	0%		
		DMO	1	8	0%	0%	60%	40%		
		S&MDO	1	8	50%	50%	0%	0%		
	TIER IV	SO	14	112	100%	0%	0%	0%	69	552
		MDO	22	176	0%	100%	0%	0%		
		DMO	22	176	0%	0%	60%	40%		
		S&MDO	11	88	50%	50%	0%	0%		
TOTAL MAN HOURS				**896**	**331.6**	**353.6**	**136**	**74.8**		
ACTUAL CHANGE				**328**	**18**	**162.4**	**72.8**	**74.8**		
% CHANGE				**58%**	**6%**	**85%**	**115%**	**N/A**		

Source: Company Documents.

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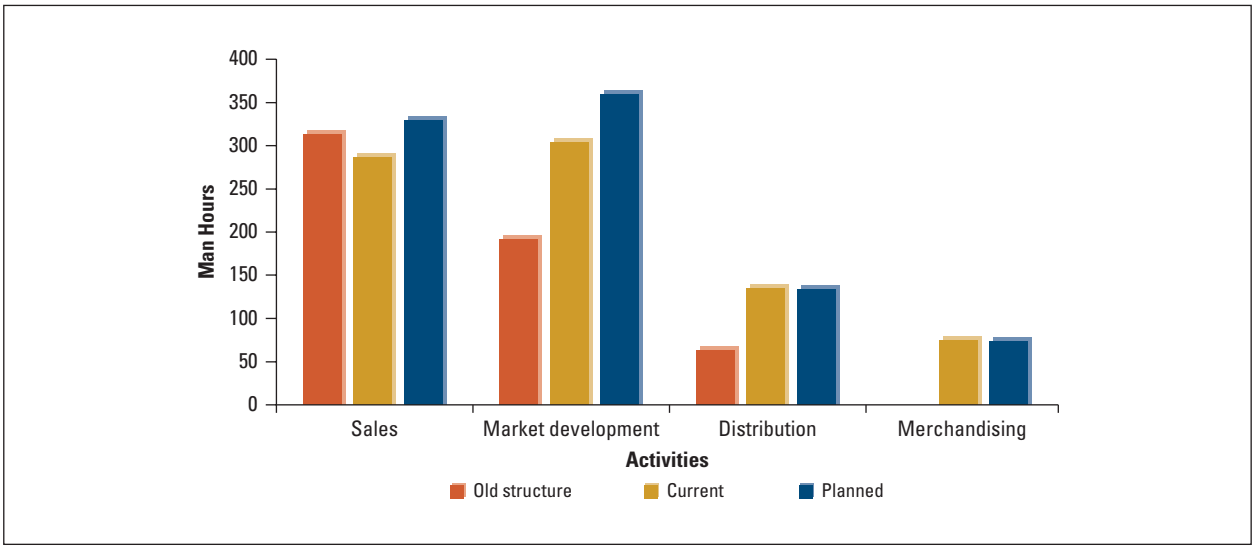
EXHIBIT 8

Man-Hours Spent on Different Activities



Source: Company documents.

An AMM shared his experience:

One person who was working with me as a fellow SO in the old structure started reporting to me in the new structure when I became an AMM and he did not. For the first month, I faced strong resistance from him. It became worse when I was invited to the marketing conference and he was not invited. In the past, both of us used to go together to the marketing conference.

Emphasis on Tier IV had a negative connotation attached to it as employees believed they belonged to the bottom-most rung of the ladder. This feeling had led to the Tier IV syndrome, which referred to the uncertainty and dissatisfaction among Tier IV officers regarding their jobs and promotions. Moreover, the company had hired a third party agency to aid in the hiring of Tier IV personnel, which resulted in several problems. Employees believed that they had been misinformed and cheated during the hiring process by the recruitment agency regarding the offered salaries. Most new Tier IV employees felt that the terms of employment should have been more explicitly stated by the third party recruiting agency.

As one AMM stated:

Tier IV SOs are unable to deliver the kind of professionalism and quality of work that is required.

According to one manager:

Dealers don't give importance to Tier IV SOs as they know that the main authority is AMM, whereas in the old structure the SO was the king of his area. Now your front-line people enjoy little autonomy/respect at dealers' level.

One major reason for restructuring was to motivate Tier III employees through a supervisory role and job enrichment. An AMM was responsible for five functional areas: sales; market development; distribution & merchandising; health, safety, and environment; and Six Sigma projects for process improvements. Without adequate support staff and infrastructure, some AMMs were feeling over-stretched.

According to an AMM:

All these five functions are required by the management to be managed from the one-room office of an AMM through only his laptop, with no support staff. He even has to make his own tea.

AMMs felt that they needed adequate staff and infrastructure support in order to be effective. They also wanted to have better quality Tier IV employees working on their teams.

One AMM suggested:

We need to improve the quality of Tier-IV employees either through training them or through attracting more talented personnel by increasing Tier-IV salaries and incentives.

Some AMMs thought that the management could have done more to prepare AMMs and SOs in advance for their new roles and expectations.

An AMM shared his feelings:

It seemed to me as if I was thrown into the pool along with my SOs in my area without adequate preparation about our new roles and what to expect. We learnt as we moved along.

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While a sense of urgency was created and overall communication within the marketing division had increased after the restructuring of the sales structure, efforts seemed to be lacking in bringing about synergy within all other divisions regarding the newly implemented changes. Other divisions included Manufacturing, Finance and Planning, Human Resource and Public Affairs, and Corporate Services. Although the restructuring idea was thoroughly discussed throughout the marketing division, Mir felt that other divisions were somewhat isolated from the discussion and they were simply informed through e-mail about the implemented changes.

As one manager noted, there was lack of sufficient IT support in the new structure. In the previous structure, all IT-related information in the Management Information and Dealer Accounting System (MIDAS) was at the authority of the zonal office and solely available to the ZMMs. Indirect link to MIDAS resulted in longer response time to customers' queries and orders and required constant communication and reporting with the head office and zonal office. Hence, when the instructions and requests finally came through to the AMM, there was a delayed response to customers. Moreover, the SO had access to a personal desktop and e-mail ID in the previous structure, but after restructuring such facilities were lacking. This meant that hard copies of e-mails, reports, queries, and so on from an SO had to be entered in the laptop by the AMM concerned to be communicated to ZMMs or other relevant interfaces. Several AMMs felt this to be merely a clerical task that contributed to delays in communication. According to one AMM, "communications were usually late and incomplete."

Khalid Mir was contemplating his next steps. How successful had the restructuring effort been? Should he continue with the new structure or was another round of restructuring imperative? How could Engro reap maximum benefits out of this newly implemented structure? What lessons could be learnt regarding change management that might be helpful in future restructuring efforts? These questions still remained to be answered.

List of Acronyms Used

AMM	Area Marketing Manager
D&MO	Distribution & Merchandising Officer
DM	District Manager
DO	Distribution Officer
FMCG	Fast Moving Consumer Goods
GM	General Manager
HSE	Health, Safety, and Environment
HO	Head Office
MBA	Masters in Business Administration
MDO	Market Development Officer
NSM	National Sales Manager
RM	Regional Manager
S&MDO	Sales & Market Development Officer
SMDO	Senior Market Development Officer
SO	Sales Officer
SOP	Standard Operating Procedures
STO	Sales and Technical Officer
TSO	Technical Services Officer
ZMM	Zonal Marketing Manager
ZO	Zonal Office

Questions

1. How would you describe the culture at Engro?
2. Why was there a need for restructuring?
3. What challenges did Engro face during the restructuring?
4. Evaluate the outcomes of the structural change.

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INTEGRATIVE CASE 5.0

The New York Times Versus Amazon*

CASE 5.0

The Letter to the Amazonians from Jeff Bezos

Dear Amazonians,

If you haven't already, I encourage you to give this (very long) New York Times article a careful read.

I also encourage you to read this very different take by a current Amazonian (Refer to Appendix A).

Here's why I'm writing you. The NYT article prominently features anecdotes describing shockingly callous management practices, including people being treated without empathy while enduring family tragedies and serious health problems. The article doesn't describe the Amazon I know or the caring Amazonians I work with every day. But if you know of any stories like those reported, I want you to escalate to HR. You can also email me directly at jeff@amazon.com. Even if it's rare or isolated, our tolerance for any such lack of empathy needs to be zero.

The article goes further than reporting isolated anecdotes. It claims that our intentional approach is to create a soulless, dystopian workplace where no fun is had and no laughter heard. Again, I don't recognize this Amazon and I very much hope you don't either. More broadly, I don't think any company adopting the approach portrayed could survive, much less thrive, in today's highly competitive tech hiring market. The people we hire here are the best of the best. You are recruited every day by other world-class companies, and you can work anywhere you want.

I strongly believe that anyone working in a company that really is like the one described in the NYT would be crazy to stay. I know I would leave such a company.

But hopefully, you don't recognize the company described. Hopefully, you're having fun working with a bunch of brilliant teammates, helping invent the future, and laughing along the way.

Thank you,

Jeff

The Article That Sparked Controversy

On August 15, 2015, a controversial front-page article in *The New York Times* shined a disturbing light on Amazon that caused speculation and concerns of its culture. The article, co-authored by reporters Jodi Kantor and David Streitfeld, harshly criticized the online retailer for its brutal and unrelenting work culture, and attempted to illuminate its harsh, cultural realities and expose Amazon publicly. Their piercing emphasis of workplace brutality shined a light on the online retailer while concerns about employees with family tragedies and health issues paled in comparison to innovation and company performance. From the testimonies of former and current Amazonians, the lengthy article echoed horrid stories that painted a picture of Amazon that is less than reputable and quite deplorable. Based on the article, the retailer was known for prohibiting employees from having any communicative interaction with the media. Despite such restraints, the Times noted that more than 100 former and current employees had provided candid experiences anonymously. The article also contained sobering anecdotes ranging from supervisors maliciously probing employees with cold-called pop quizzes to employees suffering sleep deprivation from consecutive nights of franticly working to finish assignments. The overarching premise of the article targeted a quote by Bezos in a letter to shareholders saying, "You can work long, hard or smart, but at Amazon.com you can't choose two out of three."

According to the Times, employees who align themselves with Amazon's hypercompetitive and imaginative culture are a part of the "in group" and shielded from ostracism. Particularly, employees rigorously brainstorm peculiar and inventive ideas that may become viable products and services for the sake of profitability. In a recruiting video, one employee stated, "You either fit here or you don't. You love it or you don't. There is no middle ground." One employee even noted that "if you're a good Amazonian, you become an Amabot."

According to the article, employees who hardly contribute to Amazon's success are subject to termination as part of cyclical evaluation and ostracism of underachievers often referred to as "purposeful Darwinism" by a former Amazon human resources director and "The Hunger Games" by an HR expert on CNN. Amazon currently uses a controversial technique to isolate high performers from low performers. Notarized by former Chairman and CEO of General Electric, Jack Welch, the retailer historically used an evaluative technique referred to as "stack ranking" or "rank and yank" in which employees were encouraged to viciously compete against each other, thus creating a contentious, dogmatic and cruel cultural environment. Consequently, the lowest ranked employees were eliminated, which fashioned an environment comprised of only high achievers.

* This case was written by Brian L. Matthews, Texas A&M University—Texarkana; James Harbin, Texas A&M University—Texarkana; and Jamie Daigle, Texas A&M University—Texarkana

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An internal phone directory, referred to as the Anytime Feedback Tool, was created for sabotaging others by allowing colleagues to send damaging feedback to another's superior. According to *The New York Times*, the need to compete for the top stratum created internal pressures that created tension among team members. Consequently, employees conspired to collectively give negative feedback on certain colleagues and positive feedback on each other. For example, a former Army captain, Elizabeth Willet, after having a baby and adjusting to parenthood, arranged her schedule to arrive at work at 7 a.m. and leave at 4 p.m. Subsequently, she recalled that her coworkers reported workforce deviance and poor job performance. She reportedly told the Times that her supervisor informed her that no managerial defense could refute the accusations of her peers. She quit after just over a year of employment.

Additionally, white-collar workers were perpetually placed under analytic, management and psychological scrutiny by which performance capabilities are measured using an algorithmic tool that reinforces "survival of the fittest." Blue-collar workers in warehouses find the working conditions to be grueling and intensely micromanaged to the extent of stark discomfort, including laborious toiling in 100-degree heat for hours. Former executive John Rossman says, "A lot of people who work there feel this tension: It's the greatest place I hate to work." Similarly, Eric Moore, the chief technical officer of cloud and automation at Hewlett-Packard Software Americas, stated, "Amazon was the most toxic work environment I have ever seen." Former Database Administrator from Amazon Web Services, Angela Galper, stated, "I would start crying on Sunday nights and my husband devoted countless hours to listening to my stories about my work days."

The New York Times article recounted instances in which female employees were pressured to decide between work and family. One female employee, Molly Jay, whose job performance was above reproach, began facing pushback after traveling to care for her father who was stricken with cancer. Similarly, the article tells of Michelle Williamson, a 41-year-old mother of three children, who said, in her own words, that she was emphatically told that "raising children would most likely prevent her from success at a higher level because of the long hours required." Another response from a female employee noted lack of remorse from the retailer when she gave birth and was diagnosed with cancer.

Other testimonies referenced occurrences where employees became emotionally distraught in response to compulsive debates and criticism expected of employees, thus creating a hostile and volatile work environment. Employees recall strict requirements to relentlessly dismantle the ideas of others. A former book marketing employee, Bob Olson, stated "You walk out of a conference room and you'll see a grown man covering his face. Nearly every person I worked with, I saw cry at their desk." Another testimony provided by Chris Brucia explained that he was berated extensively about his supposed poor job performance and given a punitive performance evaluation by his supervisor during a conversation where he was simultaneously being promoted.

The New York Times reported other stories denouncing Amazon's organizational norms of forcing employees to accept laborious tasks, answering emails past midnight, answering text messages even while on vacation and being reprimanded, if unreachable. A former marketing employee, Noelle Barnes, recounts that employees were mindful of the "unreasonably high" standards adopted when employment began. It was commonly known that "Amazon is where overachievers go to feel bad about themselves," he said.

Amazon's Response to Criticism

Jeff Bezos, founder and CEO of Amazon, vehemently regarded the now infamous *New York Times* article as slanderous and responded the weekend following the release. He penned a heartfelt note to Amazon's 180,000 employees, in part stating, "The article doesn't describe the Amazon I know or the caring Amazonians I work with every day." He also recommended that employees read a LinkedIn blog post written by Nick Ciubotariu, a senior Amazon employee, who candidly defended Amazon and criticized *The New York Times* for perceivably and inaccurately distorting its culture. Additionally, Bezos contended that adopting such a stringent, merciless culture would undoubtedly impede survival in today's competitive tech market. He agreed that such a relentless environment depicted in the article would not be conducive for him nor others to work and that "anyone working in a company like the one described in *The New York Times* would be crazy to stay."

Taking offense to the article penned by Kantor and Streitfeld, Jay Carney, Amazon's Senior Vice President of Global Affairs, emphatically responded to the alleged cruelty saying that "the *Times* got attention for their story, but in the process, they did a disservice to readers, who deserve better." Carney alleged that *The New York Times* misrepresented Amazon's cultural climate and misconstrued its competitive temper as an unforgiving, punishing company with mean management tactics that undermines the integrity of its employees. Carney expressed his dissatisfaction of the miscomprehended story as Kantor was asked to recant her story after continual communication took place between February and mid-August to no avail. But, while Kantor is not inclined to modify the horrific depiction of Amazon's brutal culture, Dean Baquet, *The New York Times*' executive editor, supported the merit of the article and its authors, calling it "an accurate portrait."

Regarding the credibility of the article, he reported, "Virtually every person quoted in the story stated a view that multiple other workers had also told us…The story did not assert that every Amazon employee had a difficult

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time there." In retort to Baquet's response, Carney criticized *The Times* for its failure to accurately corroborate the information it congregated with factual records to report the exactitude of Amazon's cultural climate. Also, just three days after its release, this resolve was buoyed by *The Times*' public editor who stated that the article lacked substantive, irrefutable proof to truthfully convey the reality of Amazon's culture, rather relying on generalizations and subjective anecdotes.

The Birth of an Online Bookstore

Born on January 12, 1964, Jeffrey Preston Bezos is proclaimed by spectators and employees alike, to be a boisterous, yet brazen and blunt enforcer of contentious creativity. Bezos became acquainted with computers at an early age when a company based in Houston loaned mainframe computers to his elementary school. Because his teachers were unable to decode the instruction manual, Bezos and his fellow classmates spent time learning how to program the complex mainframes. In 1986, Bezos graduated summa cum laude from Princeton University with degrees in Electrical Engineering and Computer Science.

After working for the hedge fund, D. E. Shaw & Co., he became overly interested in the astronomical growth of Internet mail order services. Intrigued by this vast, untapped opportunity, Bezos embarked upon the journey of applying the mail order model to beginning one of the world's first online bookstores. With an investment of $300,000 given by his parents, Bezos and his wife traveled to Washington State to embark upon the start of the online business in a house with an enclosed garage and two computer programmers. After developing the site, Bezos tested his prototype using 300 friends before officially proceeding publicly. He aptly named the company Amazon, after the longest meandering river in the world located in South America.

On July 16,1995, Bezos publicly launched Amazon.com with virtually no advertising budget, sparse commentary for its online product, and very little word-of-mouth assistance. Despite no press releases or a residence in Silicon Valley, Amazon quickly rose from obscurity to dominance with a searchable database of over one million books and selling to customers in 50 states and 45 countries. Rightfully so, Bezos' mantra was "Get big fast." Moreover, the idea of capturing a predominant share of e-commerce became an emergent goal while finding ways to strategically establish the Amazon brand and growing revenue. As a result, by the end of 1996, book sales reached $15.7 million, in part by offering online customers tax-free incentives. In 1997, Amazon continued its meteoric ascension when it raised a staggering $54 million in stocks, or $29.25 a share.

But, while Bezos and other "Amazonians" were celebrating its successful IPO performance, investors began doubting Amazon's capability of remaining profitable and questioned its viability. Hiring more than 7,000 employees, Amazon continued its frantic yet strategic expansion while exploring the possibility of increasing its product line and focusing on high volume sales. With the sale of CDs, videos, electronics, clothes, and other retail partnerships, Amazon's sales reached over $17 billion by 2011. Along with Amazon.com, the launch of Amazon Prime and Amazon Studios, the purchase of the *Washington Post*, among other ventures, Amazon's market value has grown larger than Walmart's at $250 billion.

Life as Amazon Sees It

"We Pioneer" are the prominent words seen on Amazon's website describing the tone of its fine-tuned culture. Bold bets, intense originality, and imagining blunt impossibilities makes Amazon a place where those who truly embody an inventive spirit can thrive. Founded in 1994, "Earth's most customer-centric company" touts its concentrated efforts to provide customers with the proposition of discovery and cost conservation. Amazon's cultural paradigm is governed by leadership principles that establish parameters that create a mechanistic organizational structure, yet prompt innovation with unyielding commitment. However, while millions have praised Amazon for its stellar marketplace dominance, life inside the retail giant may be largely secretive and believed to be grandiose in nature. Where confidentiality allows limited dialogue with organizational outsiders, Jeff Bezos and other top leaders are off limits.

Despite its unprecedented and undeniable success, the company has amassed a reputation for its stringent work conditions. While some applaud Amazon for their

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inventive way of getting the most out their employees, others view the retailer as an unrelenting, hypercompetitive and unforgiving place to work. This unrelenting, uncompromising attitude that governs intensified actions has assisted in catapulting the retail maven into an echelon all its own with market capitalization of approximately $250 billion.

The development of Bezos' leadership style reflects a telling approach and is characterized by an eagerness to govern the behaviors of others, an unfiltered conveyance of criticism bordering hostility, and a supreme need for power. Amazon's unique method of innovation requires new employees to rid themselves of poor habits learned at preceding jobs. Bezos created the company's articles of faith for regulating employee behaviors by developing mechanisms to internalize leadership principles in a synchronized, perpetual manner.

Amazon's rules are integrated into its employees' daily rituals and jargon, exploited during the hiring process and expressively quoted in food lines at lunchtime. This cultural logic guides every action, ranging from brainstorming inventive ideas and ascertaining an appropriate resolution to a problem, to interviewing peculiar candidates and practicing frugality. This dogmatic, yet peripheral focus on customer centrality and entrepreneurial proficiency reflects the following statement by Bezos when he says, "Our passion for pioneering will drive us to explore narrow passages, and, unavoidably, many will turn out to be blind alleys. But, with a bit of good fortune, there will also be a few that open up into broad avenues."

Amazon's unique communication of its culture compels and pushes employees into a world that welcomes creative thought and is believed to be "an incredibly compelling place to work," as stated by Carney. However, while touted as "incredibly compelling," Bezos warns potential candidates that "it's not easy to work here" and that "this is a culture of working incredibly hard." Renowned for having unreasonably high standards and expectations, Amazon comfortably takes pride in being a tough culture. While Google and Microsoft offer fringe benefits (i.e., gym memberships, cash for new parents) to extrinsically satisfy their employees, Amazon lacks such invitational gestures and competition along with its monetary equivalence serves as recompense for intensified efforts and unwavering pursuits of achievement.

Questions

1. Using concepts from Chapter 11, how would you describe Amazon's organizational culture? Discuss.
2. How important do you think Amazon's culture is as the cause of Amazon's corporate size, dominance, and success? Explain.
3. What do you think would happen to Amazon's competitive advantage and dominance in the marketplace if it adopted a more people-centered (clan) culture? Discuss.
4. Based on Jeff Bezos' letter to his employees about *The New York Times* article, do you think Bezos is out of touch with the impact that Amazon's culture has on its employees? Explain.
5. If your instructor assigns it, read the blog response from an Amazon executive (Nick Ciubotariu, Senior Vice President, Software Engineering at Bright Machines) about the NYT's article, at https://www.linkedin.com/pulse/amazonians-response-inside-amazon-wrestling-big-ideas-nick-ciubotariu/ How does that blog affect your opinion about Amazon's culture?

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INTEGRATIVE CASE 6.0

Lean Initiatives and Growth at Orlando Metering Company*

It was late August 2002 and Ed Cucinelli, vice president of Orlando Metering Company (OMC), sat in his office on a late Saturday morning. He had come in to prepare for some strategic planning meetings that were scheduled for the upcoming week. As he noticed the uncommon silence in the building, Ed contemplated the current situation in his organization.

The Orlando Metering Company was one of several facilities owned by a leading manufacturer of water meters for the worldwide utility industry. The facility specialized in the assembly, testing, and repair of water meters used to measure the amount of water consumed by private homes, organizations, and large cities. In 1999, OMC started the process of moving from a traditional manufacturing to a lean manufacturing organization with a fully empowered workforce. Due to the tremendous success the organization had achieved, the corporate headquarters decided to transfer four new product lines to the Orlando facility in 2001. This transfer resulted in considerable expansion of the business, doubling the number of employees and shifts needed at the plant and quadrupling the revenues of the organization. As Ed looked through some old pictures on his desk, he reflected on how proud he was of everything that his leadership team and employees had been able to accomplish in the short year-and-a-half timeframe that was given to them by the headquarters.

However, the organization was currently experiencing some very tough challenges due to the recent change and expansion. Although OMC successfully brought in the new business, Ed and his management team made some mistakes in the transition. When he walked through the production floor, Ed could feel that the energy and commitment of the employees were at an all-time low. He knew that his current 108 employees were stressed and unhappy. Turnover and absenteeism were at an all-time high, and productivity and quality were suffering. The organization had lost a lot of the momentum it had gained in its implementation of lean manufacturing. Just last week, Ed had received a call from his supervisor at corporate, expressing concerns about the current situation at OMC. The corporate headquarters had given Ed and his leadership team three months to turn things around and show some improvements.

Ed knew that it was time to take some serious action. He knew that the process side of planning the inventory and physically assembling the meters according to the principles of lean manufacturing were working efficiently in his facility. However, the company had lost the team-based, lean manufacturing culture in which the employees took ownership and worked together as a team to solve problems and run their own work cells. He knew that to truly take advantage of the potential of the lean layout and processes operating in his plant, the company needed to have the culture to support it. Ed knew that it was the right decision to keep the lean production process in the operation, inventory planning, and assembling meters. However, he needed to decide whether to refocus the organization on re-establishing the *team-based, lean culture and thinking* that it had lost or return to the traditional top-down management methods of the past.

Background

Fresh out of college, Ed began his career at OMC in 1993 as a mechanical engineer. The company was originally founded in Orlando, Florida in 1974. The PMG group, OMC's parent company based in Europe, was seeking growth opportunities and saw the United States as a great opportunity given the size of the market and the fact that OMC's product offered a new technology compared to those available at that time. There were many styles of water meters for different applications, and OMC's new product at that time provided a solution to issues within the market, mainly suspended solids (i.e., sand) in the water. Traditional meters would slow down and stop due to suspended solids, thus reducing a water utility's revenues. This new meter allowed the suspended solids to pass through and provided better accuracy for measuring water use, thus increasing revenues. Therefore, the meter quickly gained acceptance in many markets and the company had grown since the new meter's introduction.

As sales continued to increase, so did the number of employees and the need for more space. Ed was in charge of designing and overseeing the construction of a new facility. Having no prior experience of working within a lean enterprise, Ed designed the new facility

* This case was prepared by Wanda Chaves from Ringling College of Art and Design and Ed Cucinelli from Crummer Business School. The views presented here are those of the case authors and do not necessarily reflect the views of the Society for Case Research. The authors' views are based on their own professional judgments.

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as a larger model of the old. Adding more space and more equipment did not create a more efficient workplace, but with the right people, the company still accomplished the job. As he sat in his office, Ed remembered the long nights working side by side with maintenance, quality, and production personnel, all trying to ensure that the new facility move would be successful. The power of teamwork was evident as the employees completed the project in a timely fashion and production efficiencies remained stable. At this time, many of the employees at OMC had been with the company for nearly 10 years. Employees knew each other and each other's families, and they felt a sense of responsibility to one another. Even though OMC did not have the best tools, offered a compensation package that did not exceed the market average, and ran without air-conditioning, the employees felt that they belonged to something special.

The Decision to Go Lean

In 1998, OMC's parent company was purchased by a much larger competitor. Soon after, the board of directors came to Orlando for a board meeting. The board decided to pursue a lean manufacturing culture within the organization. At that time, however, none of the company's facilities operated in a lean manner. As a test and learning experience, the board decided to challenge the Orlando plant, and it gave the facility an aggressive nine-week timeframe within which to implement the reconstruction of the production floor and change the manufacturing process to lean.

At this point, Ed accepted the position of Lean Champion, where he became responsible for implementing the lean changes and initiatives. Ed knew that all of the employees at OMC would need to be involved if the organization was to successfully achieve this nine-week goal. Immediately, the leaders of the plant held a plant-wide meeting and outlined the goals. Everyone quickly realized that the small Orlando facility would be closed and relocated to one of the large sister facilities if the change was not successful. Ed organized the employees into teams, conducted lean training, and provided constant management of the project and deadlines. All employees responded, and through long hours, many weekends, and a lot of sweat, all production lines and half of the office processes were converted to utilize the lean concepts. Exhibit 1 details the specific timeline that was developed and accomplished.

Background on Lean Manufacturing

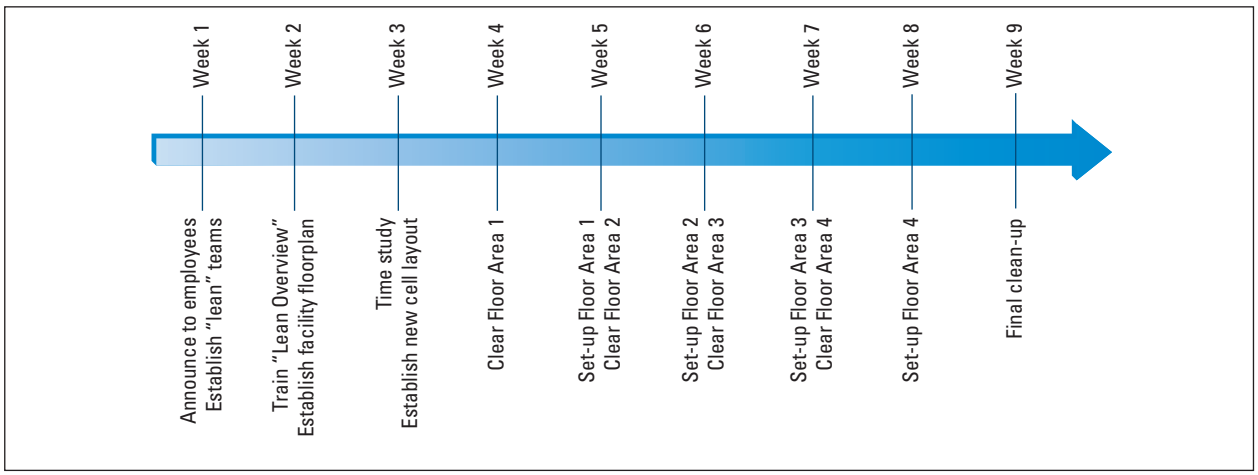
The goals of implementing lean manufacturing at the OMC facility included improving material handling, inventory, quality, scheduling, personnel, and customer satisfaction. In general, the key objectives of the lean facility's layout and flow were to deliver high-quality, low-cost products quickly while maintaining a safe and pleasant working environment (Henderson and Larco, 1999). By implementing just-in-time (JIT) production, one-piece flow, self-directed work teams, and cellular manufacturing, the leaders expected the following improvements to occur as part of the new lean environment:

1. A decrease in the cost of space, inventory, and capital equipment
2. A reduction in throughput time, cycle time, or lead time
3. An increase in capacity utilization
4. A reduction in lost-time accidents

Exhibit 2 details the strategic advantages of implementing lean manufacturing.

EXHIBIT 1

Nine-Week Project Timeline



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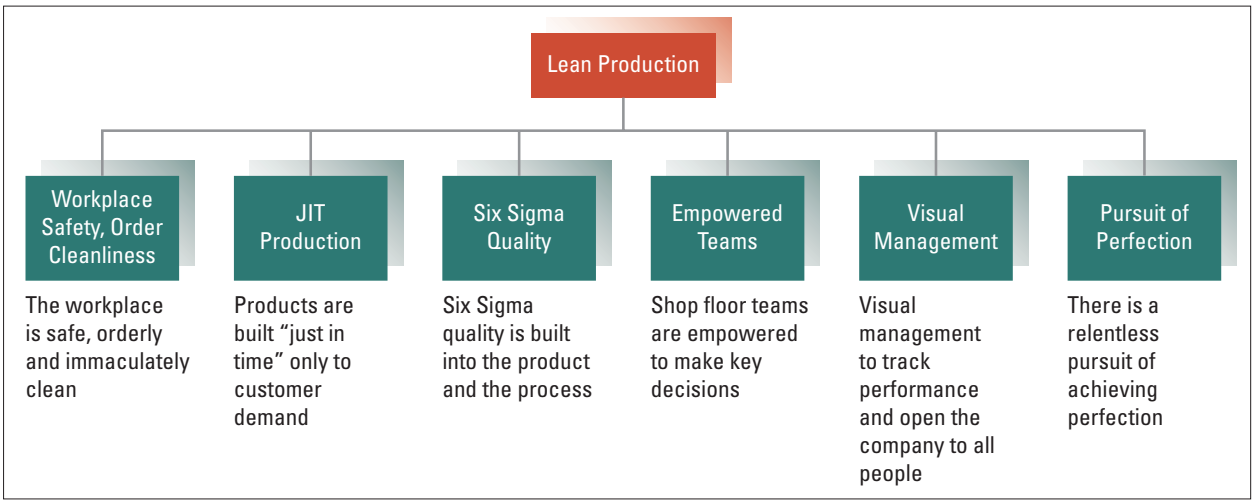
Lean is not only a production system of tools and processes to continually improve, but it also involves implementing a culture and atmosphere in which the systems and tools can be best utilized. Without the culture and support of all the people, the benefits cannot be maximized. Exhibit 3 illustrates the principal components of lean production, and Exhibit 4 provides details on lean management and the key elements needed to sustain a lean manufacturing culture.

EXHIBIT 2
Strategic Advantages of Lean Manufacturing

Manufacturing lead time	Reduced by one day
Delivered quality	Three parts per million (PPM)
Delivery performance	99+ percent
Inventory turns	Greater than 50
Conversion cost (materials to finished goods)	25 to 40 percent less than mass producers
Manufacturing space	35 to 50 percent less than mass producers
New product development	Less than six months

Source: B. A. Henderson and J. L. Larco, *Lean Transformation: How to Change Your Business into a Lean Enterprise* (Richmond, VA: The Oaklea Press, 1999), 42.

EXHIBIT 3
Principal Components of Lean Production


Lean Production
Workplace Safety, Order Cleanliness
The workplace is safe, orderly and immaculately clean
JIT Production
Products are built "just in time" only to customer demand
Six Sigma Quality
Six Sigma quality is built into the product and the process
Empowered Teams
Shop floor teams are empowered to make key decisions
Visual Management
Visual management to track performance and open the company to all people
Pursuit of Perfection
There is a relentless pursuit of achieving perfection

Source: B. A. Henderson and J. L. Larco, *Lean Transformation: How to Change Your Business into a Lean Enterprise* (Richmond, VA: The Oaklea Press, 1999), 46.

EXHIBIT 4
Principal Elements of Lean Management

Element	Key Characteristics
Leader standard work	Daily checklists for line production leaders—team leaders, supervisors, and value stream managers—that state explicit expectations for what it means to focus on the process
Visual controls	Tracking charts and other visual tools that reflect actual performance compared with expected performance of virtually any process in a lean operation, production and nonproduction alike
Daily accountability process	Brief, structured, tiered meetings that are focused on performance with visual action assignments and follow-up to close gaps between actual results versus expected performance
Discipline	Leaders themselves consistently following and following up on others' adherence to the processes that define the first three elements

Source: D. Mann, *Creating a Lean Culture: Tools to Sustain Lean Conversions* (New York: Productivity Press, 2005), vi.

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Becoming the Lean Showcase

Next, the employees and leaders needed to work together to transform the company into a lean showcase. Ed knew that simply making changes to the production processes would not create the lean showcase that the board expected. Although employees were supportive and dedicated, the management team provided most of the direction and led the change. As discussed above, one of the critical elements to the successful implementation of a lean environment is the development and maintenance of a self-directed, empowered workforce (Henderson and Larco, 1999). Ed realized that the time had come to transition to team-based production lines. Over the next few months Ed and the OMC leadership team, with the help of a trainer, began an intensive team-based training program. The employees went through team skills training, including sessions on feedback and communication, problem solving, meeting skills, team dynamics, and an informal session on company financials. The teams began to see the results of the training and hard work. They began to run their own team meetings and suggested and implemented eight to 10 improvements a week in areas such as quality, safety, and productivity. The employees were motivated and encouraged by all of the progress and success.

At the same time, the leaders at OMC were focused on making a more comfortable and friendly work environment. This was accomplished by adding new lighting that tripled the brightness of the facility; painting the floor, walls, and equipment; and installing air-conditioning. Leaders even placed live plants throughout the facility. These changes helped promote the concept that employees played a key part in the success of OMC. The facility looked clean and beautiful. Exhibit 5 provides before and after pictures of the facility.

After an 18-month implementation cycle (which included the physical changes to the manufacturing floor as well as the implementation of lean manufacturing production and administrative processes), the organization was able to achieve the following benefits:

- The managers and employees were able to reduce inventory by 50 percent and completely eliminate finished goods.
- Quality control changes resulted in the conversion to 100 percent testing of all products without adding any additional employees or equipment.
- The plant was able to cut total production cycle times from days to minutes (typically one to two days to process reduced to five to 15 minutes).
- Total floor space was reduced by 41 percent (so much that a basketball court was added within the facility), as displayed in Exhibit 6.

Exhibit 7 details the cost involved during the nine-week transformation of the physical manufacturing floor to lean production.

Working together, the employees and leaders had succeeded in establishing the lean showcase, and the board of directors took full advantage. People from sister companies around the world came to Orlando. They toured the facility to learn about lean manufacturing and the best methods to implement it. Tours were given by the employees. There was no better evidence of the power of lean manufacturing and empowerment than seeing an hourly employee give a presentation to a VP of operations of another facility. Morale was at its highest point ever. There were no obstacles that this Orlando facility could not overcome. At this point, Ed and the leadership team knew that the OMC facility was being underutilized. They needed more business.

EXHIBIT 5

Physical Changes to OMC Facility

Sources: B. A. Henderson and J. L. Larco, *Lean Transformation: How to Change Your Business into a Lean Enterprise* (Richmond, VA: The Oaklea Press, 1999).

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EXHIBIT 6
Reduction of Floor Space at OMC

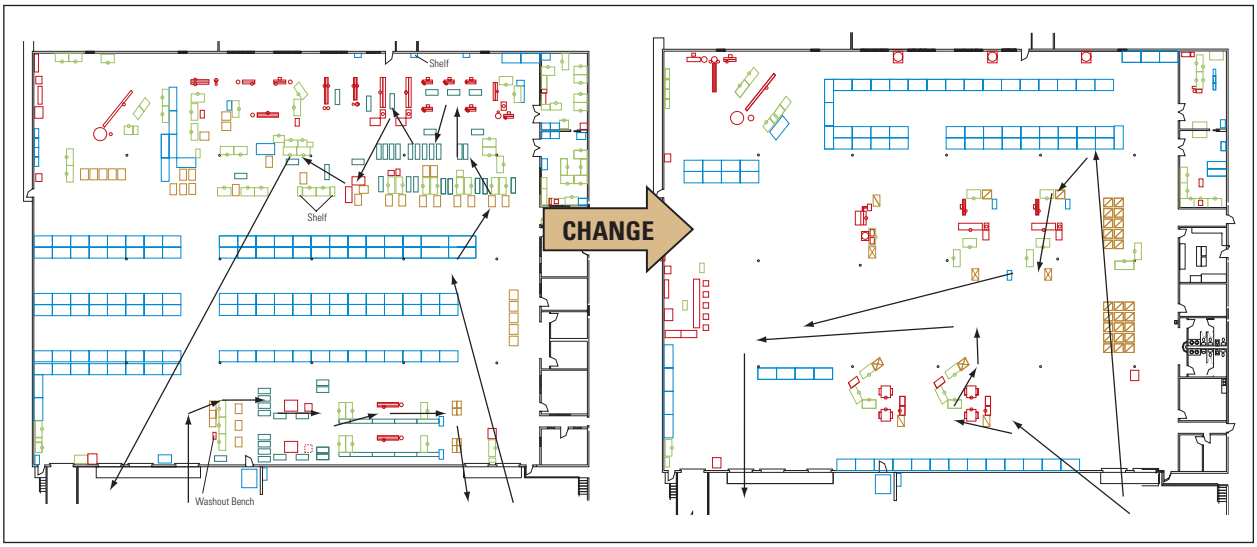

EXHIBIT 7
Project Costs

"Nine-Week" Phase Costs		"Showcase" Phase Costs	
Equipment & tools	$15,000	Air conditioning	$250,000
Lost productivity	$10,000	Floor coating	$120,000
Lighting	$10,000	Equipment & tools	$45,000
Training	$6,000	Painting	$33,000
Supplies	$4,000	Training	$12,000
	$45,000	Supplies	$10,000
			$470,000

Over the next year, the Orlando facility continued to be the "showcase." Performance continued to improve. The rapid success of OMC captured the attention of OMC's customers as well as other corporate officers. In 2001, the board decided to relocate four new product lines from a sister facility to OMC. Although OMC had installed new production lines in the past, this change represented a much larger scale. It would require doubling the workforce, quadrupling sales, and converting the existing production lines to utilize the lean concepts, all within 18 months.

Rapid Growth at OMC

Ed was the project manager responsible for the transition of the new business into the Orlando facility. However, nine months into this project the current VP of operations was promoted and Ed became the VP of operations, in charge of the entire Orlando facility.

Although slightly behind schedule, Ed and his leadership team and employees completed the project in 20 months, and they exceeded the projected savings. Lean manufacturing again provided significant benefits to the OMC operations. Through the change, OMC achieved significant savings in labor costs, floor space, and process times, as exhibited in Exhibit 8.

Ed enthusiastically led the new change, but the technical challenges in the transition of this product proved more difficult than expected. The union facility from which the product was transferred relied solely on the worker's experience in manufacturing the meters, so the facility had kept limited product and process documentation. The engineers at OMC constructed new test equipment to replace the 40-year-old technology previously used. There were also many challenges with the products, as many of them were designed nearly 50 years earlier and meeting current quality demands proved difficult. The project had placed

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EXHIBIT 8
Savings Achieved Through Lean at OMC

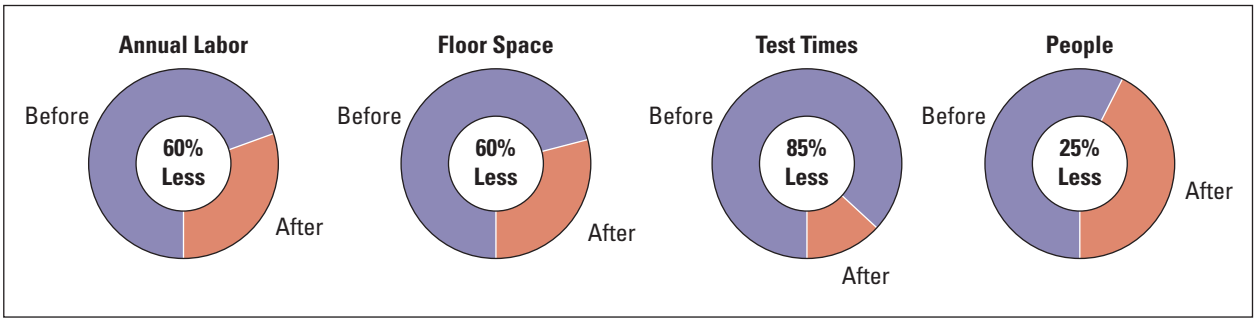
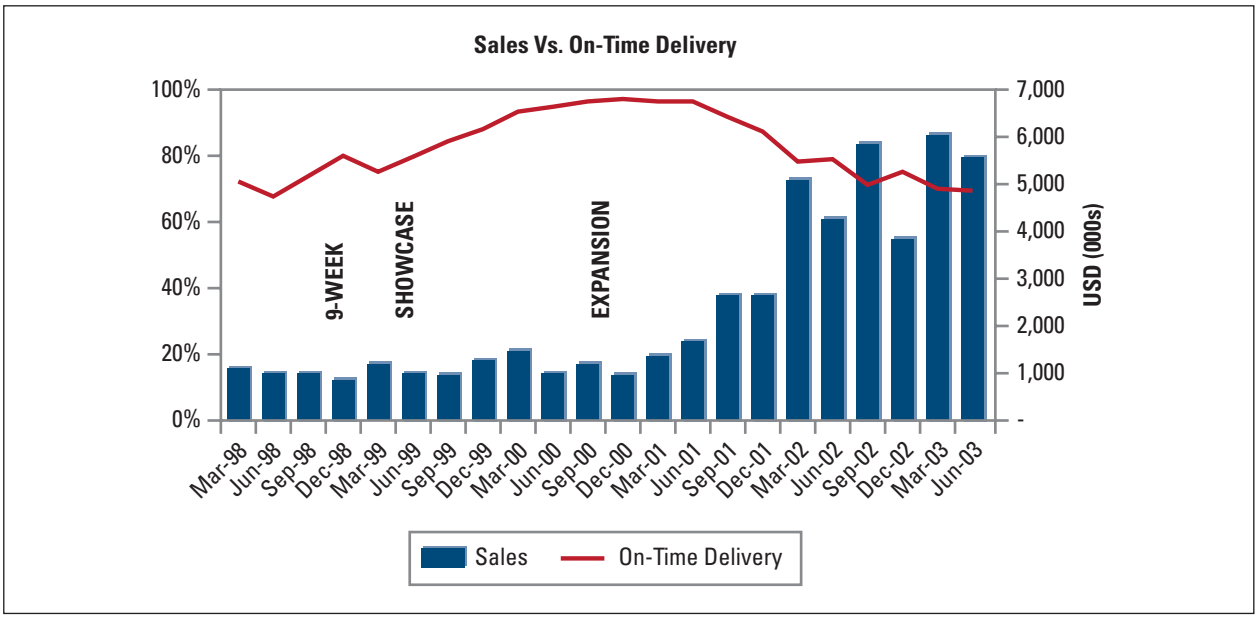


EXHIBIT 9
Changes in On-Time Delivery



a large strain on the resources in the Orlando facility, and many sacrifices were made. In order to ensure that the project was completed on time and that the change was seamless for the customer, the leadership team focused heavily on overcoming the technical hurdles with the production of the new meters. In doing so, the team failed to address the impact on the employees and the other critical people issues that arose during the change process. The leadership team quickly learned that the success it had experienced in the recent past would be short-lived, as the lean culture had deteriorated and the team-based structure no longer existed at OMC. Exhibits 9, 10, and 11 detail the longitudinal changes in on-time delivery, turnover, and inventory turns as a function of OMC's sales.

Exhibit 12 summarizes the overall timeline of the changes that have occurred at OMC since the facility was built in 1996.

Current State at OMC

Ed now sat in his office contemplating the current state of the organization. It had taken 20 months to complete the project, and OMC had increased its number of employees from 50 to its current total of 108. Ed and his leadership team had relied heavily on the use of temporary agencies to provide them with new employees. Ed looked at the latest staffing sheets on his desk and calculated that 40 percent of OMC's current employees were temporary workers hired through the staffing agencies. The decision to use temporary employees was not Ed's preference. Without a human resource department to accommodate the rapid growth, Ed lacked enough qualified staff to help with the rapid recruiting, interviewing, and hiring of 58 additional employees. Therefore, he and the leadership team had resorted to the use of temporary agencies. His hope had been that the temporary agency would do the pre-screening for OMC and

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EXHIBIT 10
Changes in Turnover

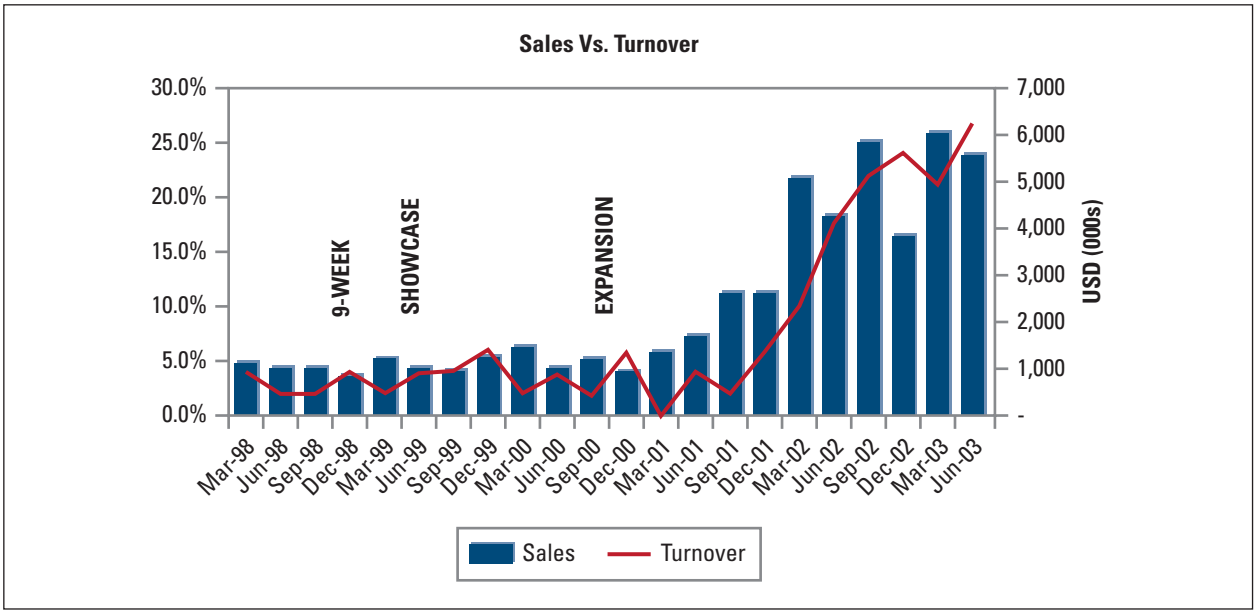

EXHIBIT 11
Changes in Inventory Turns

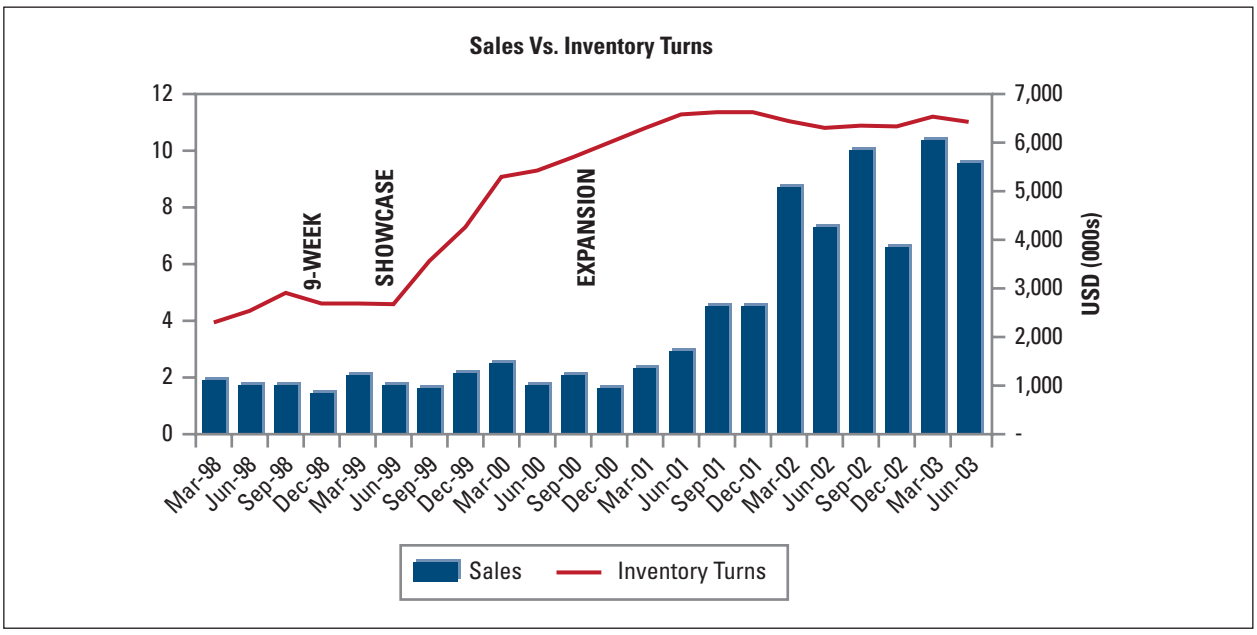

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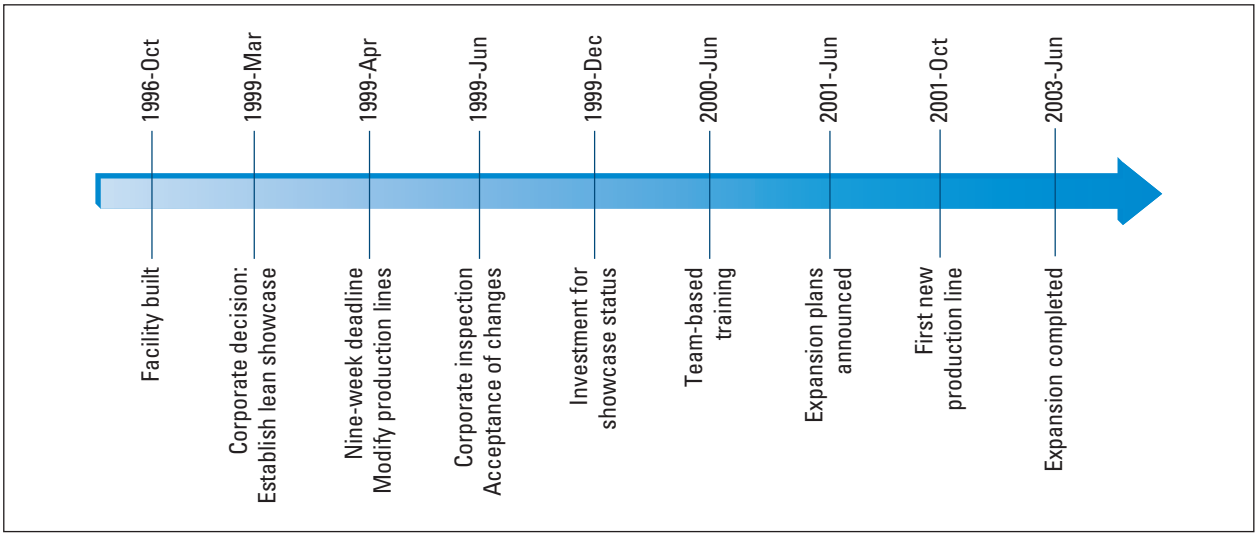
EXHIBIT 12
Overall Timeline for OMC Changes



recruit qualified individuals whom OMC could later hire into full-time positions. However, the lack of appropriate qualifications, low levels of loyalty, and high turnover of the temporary staff, as well as the fees and costs involved in maintaining the temporary employees, had caused a large setback for OMC in its maintenance of the lean, team-based culture that had started to develop when the organization was much smaller.

Ed also re-evaluated the decision made by him and the leadership team regarding the training and integration of the new employees into the workforce. Ed and his team had decided to disperse the existing employees throughout the various production lines, both new and old.

The intent was to provide a solid base of experienced and self-directed employees within each cell, lean-thinking employees in each new production area, as well as to retain some experience in the already existing production lines. However, the leadership team failed to provide the proper training and attention needed by the employees and relied too heavily on the experienced employees to help and informally share their knowledge and experience on lean and the production process with the new employees. The new employees received very little formal training on the technical aspects of their job and on lean culture and teams. Instead, they were placed within the work cells and expected to learn primarily by observing and doing. This had worked well for OMC in the past when it was a much smaller company; however, the changes that had occurred at OMC in the past had not been such large-scale changes that needed to be completed within a very tight timeframe. In hindsight, Ed now realized the importance of formal training and the constant support needed by employees through such a large, accelerated change. The lack of both had now resulted in the dismantling of the lean, team-based culture that had previously been established at OMC. The company still had the lean production processes in place, but the fact that it had neglected to sustain the lean culture throughout the growth processes had caused the serious problems that OMC now faced.

The culture of the organization changed drastically due to the tremendous growth that OMC had undergone. The organization moved from a small, one-shift, family-oriented organization to a midsized, two-shift organization in which many of the employees did not know each other's names or each other's jobs. At this time, 60 percent of the workforce had been with OMC for less than one year, including most of the management team. This was an especially difficult change for those employees who had been with the organization for 10 or more years and had seen the organization's culture change so significantly. The constant flux of new employees, the lack of effective training, and limited communications had challenged, frustrated, and stressed the employees on all the teams in the facility on a daily basis. Ed thought back to just a short year and a half ago when OMC was the lean showcase. At that time, the teams were so successful and confident that the teams and the leaders felt that there was nothing the teams could not accomplish. Today, he thought in dismay, every team in the facility was faltering.

Even members of the management team had lost focus on the lean culture as day-to-day activities consumed all their efforts. With more than half of the management team arriving after the lean transformation, the personal commitment and management styles varied. The manufacturing manager had been at OMC for one year. He was experienced in team-based organizations and

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slowly won the support of the production employees. His preference was a high level of team-based management. The engineering manager had worked at the company for seven years. He was a major contributor to the success in growth and development of new equipment and had excellent technical and design abilities. His preference was for top-down management and tight control of the engineering and maintenance department. OMC's finance manager was in her sixth year with the organization. She was very experienced and understood business in general and saw the financial impact of the lean implementation and culture. Her preference was for a team-based approach to management.

The materials manager had been with OMC for one year and was very experienced in materials and processing. However, he struggled with lack of information from OMC's outdated business systems. He supported team-based management functions within a salaried workforce; however, he did not believe hourly workers would perform at optimal levels without direct supervision. The quality manager was in his sixth month at OMC. His prior experience was within tightly controlled industries where teams existed, but strict controls limited the ability of these teams to make significant changes. Given his experience, he preferred team-based operations with a limited scope on teams' abilities. Finally, the human resources manager was in his first month at OMC and had strong prior experience in recruitment and personnel development; however, he had limited experience in lean manufacturing. His focus was to rely heavily on the policies, procedures, and benefits provided by the corporate office. Overall, Ed felt that the management team had the technical skills necessary to move the organization to the next level of lean in terms of production. Yet he had struggled in bringing the team together in terms of their understanding and support for the lean, team-based culture that he was trying to maintain within his organization.

Ed once again examined the staffing data on his desk and reviewed the turnover and absenteeism figures he had been tracking. Turnover in the organization had risen to alarming numbers, with an average of one new temporary or full-time employee leaving every day for the first six months after the change. Ed cringed at the thought of the costs that OMC was incurring due to the turnover and the temporary agency fees the company was still paying. Absenteeism rates were also very high, averaging nearly 50 individual absences each month.

The instability in the workforce had also elevated labor costs, which, in turn, increased manufacturing costs to a point where corporate had started to show concern and demanded immediate improvements. Productivity dropped 25 percent in comparison to the past performance of the organization. This instability had also impacted the quality of the product and on-time deliveries, and as a result there had been an increase in the number of customer complaints.

Ed had received a phone call last week from corporate. The expectations were that the organization needed to improve results within three months; otherwise, corporate would dictate future changes to the people in Orlando. Ed now stood by the window in his office and reflected on just how quickly success and performance can diminish and disappear. He was confident that OMC would meet the goal set by headquarters, as it had done in the past. This time, however, the situation was different given the current levels of low morale and instability in the workforce. He needed to take immediate action. The question was, should he try to re-implement the lean manufacturing culture and lean thinking in the new organization or should he abandon this goal and instead focus on re-establishing the traditional management methods of the past?

Questions

1. What is your understanding of lean manufacturing? How does it differ from a smart factory?
2. Why do you think employee morale is low? Explain.
3. How would you describe OMC's culture? What caused the change in culture?
4. What should Ed do now to reduce turnover and absenteeism?

Sources

B. A. Henderson and J. L. Larco, *Lean Transformation: How to Change Your Business into a Lean Enterprise* (Richmond, VA: The Oaklea Press, 1999).

D. Mann, *Creating a Lean Culture: Tools to Sustain Lean Conversions* (New York: Productivity Press, 2005).

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INTEGRATIVE CASE 7.0

SCG Lampang: Overcoming Community Resistance to a Sustainability Project (A)*

"Wanting to 'do good' for the environment and the villagers is not enough," said Daniel Anuwat*, Sustainable Organization Manager at Siam Cement Group's (SCG) Lampang Cement Plant. "The people in the villages around the plant were threatened by the check dam idea. They were extremely resistant to our efforts to transform the deforested countryside into vital and productive green spaces." Looking through his notes from that period, Anuwat produced a letter from an NGO demanding that reforestation efforts stop immediately.

Anuwat's parents emigrated to the USA from Thailand before he was born. He had visited Thailand as a child with his parents, and visited again while traveling in Southeast Asia during a 30-day leave from the Navy. He felt drawn to a sense of peacefulness and balance in the country, perhaps reflecting the dominant Buddhist religion. People were caring and helpful toward one another. After completing his navy enlistment, Anuwat studied the Thai language and after graduation from college decided to move to Thailand. While improving his language skills and looking for work, he heard about the company called SCG that took great care of its employees. He applied for work and was hired as an executive assistant for a cement plant. Promotion to supervisor came after a few years, and later he transferred to the sustainability department, where he became director. As part of SCG's sufficiency philosophy, promotion from within is always the preferred way to fill manager positions.

Anuwat was proud of SCG's efforts to create a sustainable environment. He recalled the frustration from what appeared to be the backward thinking of the villagers. Logic and reason did not persuade them. Engaging the villagers to help themselves and their natural environment by implementing check dams was a lot more difficult than leaders at Lampang anticipated.

Check Dams and Water Preservation

Thailand experiences months of abundant rain and months of very little rain. The purpose of check dams is to slow the speed of water flow, preserve rainwater, prevent drought, reduce soil erosion, trap sediments, and allow moisture to seep deeply into the surrounding soil. Local people, using local, inexpensive and mostly natural materials, can build a check dam at low cost. A check dam might range in length from five to 50 feet across a drainage ditch, rivulet or brook. Rocks, gravel bags, bamboo pilings, wire fencing, and tree trunks or branches can comprise a check dam. An analogy would be a small beaver dam. Check dams are not permanent concrete dams because water is also needed farther down the hill or mountain. So, the dams typically need repair every year or two. See Exhibit 1 for check dam photos.

Constructing a check dam as envisioned by SCG might be analogous to a small barn raising in the United States with a picnic-like atmosphere. A group of neighbors can get together to build something of value for themselves and the entire community. SCG's CEO, Roongrote Rangsiyopash, said that a team of 20 people in one day could build 20 check dams. The dams are built during the summer dry season. Given appropriate topography, check dams could exist every 50–100 feet down a sloping ravine, creating a series of pools of standing water.

Simple moisture retention in the soil for longer periods contributes greatly to reforestation in dry areas. The moisture facilitates forest growth during dry periods. Reforestation contributes to the return of plants and animals. Added soil moisture also makes farming more productive in the area. SCG leaders believed that as rural communities mastered the principles of water preservation via check dams, a next step would be to collect water in small reservoirs for direct irrigation of farm plots.

Village Culture and Beliefs

Thai farmers usually live in small-town farming communities. Farmers' land plots average about one acre. The Lampang area is rich agriculturally because of its

*Written by Richard L. Daft and Sooksan Kantabutra, with special thanks to Nuttasorn Ketprapakorn, Eggaluck Suwannakarn, Amornrut Det-udomsap, Chatchai Chatpinyakoop and Thong Nguyen for their superb work helping interview SCG executives and local villagers. We also express our deep appreciation to SCG's CEO, Board of Directors committee chair for CSR projects, Lampang cement plant Managing Director, Community Relations Director, Director of Sustainability, other Lampang employees, and local farmers and villagers for providing information for this case.

*Anuwat is not a real person. The name is a pseudonym representing a shared management perspective.

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EXHIBIT 1
Check Dams in Progress and Completed

The Siam Cement Public Company Limited (SCG)

location in a fertile valley. A typical village has about 100 families and maybe 600 people. Houses are typically two stories on stilts. Traditional families live in the two levels and may have livestock like pigs or ducks on the ground level. Villages have few businesses and few services other than an elementary school, so they have to go to a larger city for other services. Much of the rural population is poor and not well educated. Beliefs and values are traditional and may seem superstitious to outsiders. A Buddhist temple is often located near the village center. The temple is the village center for holidays, festivals, spiritual activities and funerals.

A village headman is elected by the residents and plays an active role in a village. The headman makes announcements over a public address system each morning, helps resolve disagreements, and may even help distribute mail.

Farmers typically raise two crops of rice a year. Culturally, villagers have learned to burn fields and unwanted brush to get ready for a new planting of crops. Farmers believe that to get good quality soil, they have to burn away crop residue to return nutrition to the soil and provide better land quality. Local people also use the forest as a source of food (wildlife, mushrooms), firewood, and fodder. A headman likened the forest to a supermarket because people could gather vegetables and other edible products and sell them locally. People might set fire to leaves and groundcover in the forest for various purposes, such as germination of mushrooms and other edible plants, and to force animals from hideouts for hunting. Local people value the use of fire, although fire does damage a forest when out of control.

Thailand's Sufficiency Economic Philosophy

In the 1990s, the King of Thailand introduced the Sufficiency Economic Philosophy (SEP) to Thailand as a potential guide for corporate behavior. SEP emphasizes moderation, reasonableness and prudence in business management with the goal of sustainable wellbeing in the areas of economy, society, culture, and the environment. SEP in personal and business terms would mean giving up the need for excess or overindulgence. SEP is like the triple bottom line (society, environment, economic) or stakeholder theory in the West. The priority is to achieve balance across the needs of various groups rather than focusing only on the short-term profit maximizing (economic) goal that was dominant in Thailand. The prevalent short-term profit approach was believed to be a major reason many companies went bankrupt and thousands of people lost their jobs during the 1997 Asian Financial Crisis.

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A business illustrates the sufficiency philosophy when it implements values and morality as basic tenets, invests in the future even when it limits short-term profitability, does not take advantage of employees, customers or shareholders, creates a strong positive corporate culture, and regards employees as a key asset, retaining them even during financial loss.

SCG's Strong Culture and Values

Within this national context, SCG leaders developed a strong sustainability philosophy.

SCG employs about 54,000 people in three divisions—(1) Cement-Building Materials, (2) Chemicals, and (3) Packaging. The three divisions have 51 subsidiaries. SCG is solidly profitable. The sales and profit figures for 2017 are in Exhibit 2.

SCG's corporate structure is illustrated in Exhibit 3. The high value given to sustainability is illustrated by the CSR Committee for Sustainable Development on the Board of Directors and the community relations units in each division. Many of the 51 subsidiaries also have formal positions for both community relations and sustainable development.

Leaders at the corporate and subsidiary levels have shaped a strong culture that includes robust sustainability values. The SCG corporate vision statement includes sustainability:

SCG will become a regional [Southeast Asia] business leader with emphasis on INNOVATION and SUSTAINABILITY

SCG Core Values are:

1. *Adherence to fairness*
2. *Dedication to excellence*
3. *Belief in the value of individuals*
4. *Concern for social responsibility*

The SCG Lampang Cement Plant Subsidiary added four commitments of its own:

1. *Create jobs*
2. *Develop community*
3. *Preserve environments*
4. *Be a good citizen of Lampang*

SCG values are not just posted somewhere and forgotten. They are posted everywhere! Waiting for an elevator, employees will see the doors covered with huge pictures of top executives illustrating one of the core values or a new sustainability project. Executives also make decisions publicly to illustrate the preference for core values over short-term profit. For example, the CEO said that he made recent decisions in which people needs were chosen over academic knowledge and employee safety was chosen over cost efficiency. In public addresses and all-hands meetings, the corporate values are repeatedly stressed, and leaders are encouraged to walk the talk.

Every year a sustainability report lists hundreds of ongoing projects and the key performance indicators (KPIs) that show amount of progress. Example corporate KPI projects include reduced energy consumption, use of alternative fuels, new eco-value products and services, recycled water, green procurement, and number of check dams. Sustainable Development at SCG has its own website with current data on all projects and new projects undertaken. Moreover, the Chair of the Board of Directors' CSR committee stressed that each plant has its own set of KPIs to track progress on initiatives relevant to its local situation.

One manager mentioned, "We ask employees to participate in one SD (sustainable development) project in their local community. This creates a new mindset within employees by engaging them in the SD process. We live within the community, not as outside people. Everyone participates in taking care of society." He added, "We never force anyone to do anything for their community. We never force anyone even a little. It is their problem and we help them find a solution that works for them."

A staff engineer stressed the unique value of the strong brotherhood and sisterhood element of SCG's culture. Peers and direct reports are brothers and sisters, and bosses are older brothers. People at any level can talk directly to other departments to request help or a task order. They can respond promptly without an official order or document. During orientation, freshmen (new employees) are briefed on the brother and sister culture. Then small groups of freshmen are asked to build a check dam together so they have the experience of bonding during a shared sustainability project.

EXHIBIT 2

SCG 2017 Financials

Financial Performance 2017 (USD, 000s)

	SCG Public Co. Ltd	Lampang Subsidiary
Total Revenues	$13,756,020	$117,051
Total Expenses	$12,477,010	$ 99,325
After-tax Profits	$ 1,679,110	$ 11,765
Return on Assets	9.9%	8.4%
Return on Equity	22.0%	42.6%
Return on Sales	12.2%	12.5%

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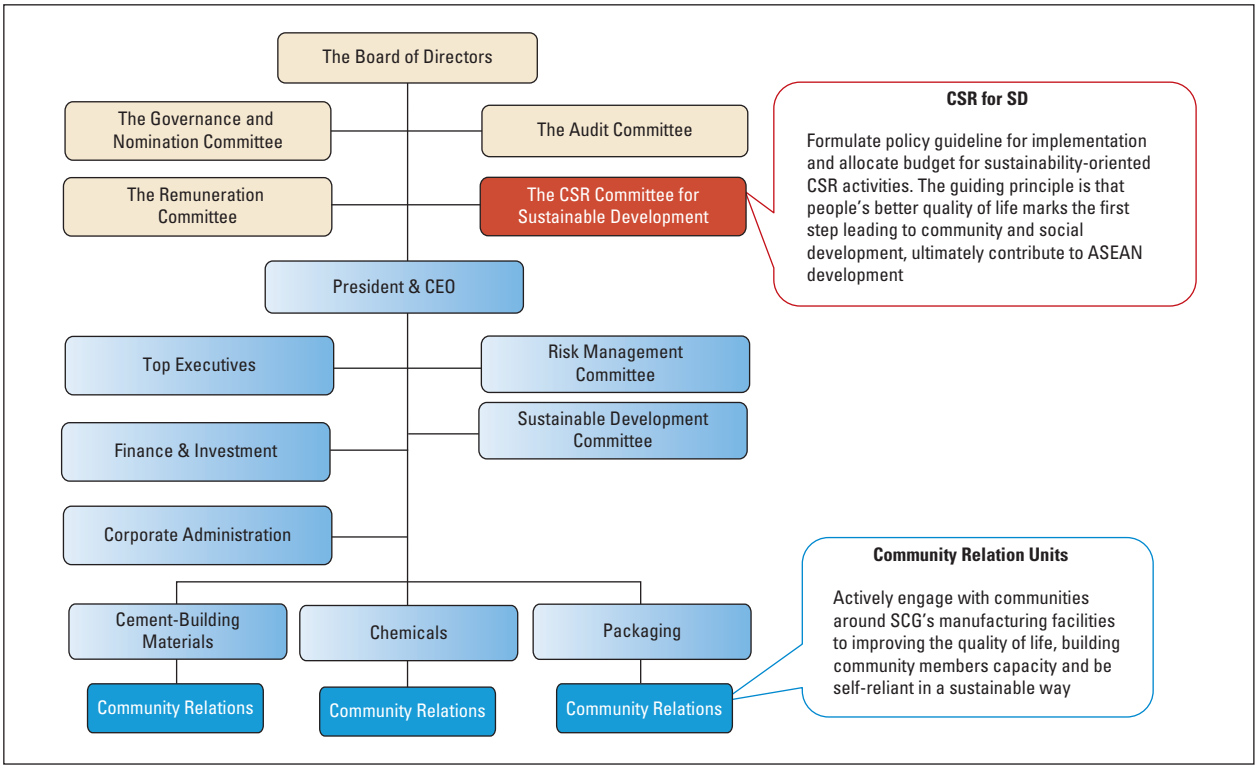
EXHIBIT 3

Corporate Structure for Sustainable Development


The Board of Directors
The Governance and Nomination Committee
The Audit Committee
The Remuneration Committee
The CSR Committee for Sustainable Development
President & CEO
Top Executives
Risk Management Committee
Sustainable Development Committee
Finance & Investment
Corporate Administration
Cement-Building Materials
Chemicals
Packaging
Community Relations
Community Relations
Community Relations
CSR for SD
Formulate policy guideline for implementation and allocate budget for sustainability-oriented CSR activities. The guiding principle is that people's better quality of life marks the first step leading to community and social development, ultimately contribute to ASEAN development
Community Relation Units
Actively engage with communities around SCG's manufacturing facilities to improving the quality of life, building community members capacity and be self-reliant in a sustainable way

The Managing Director of the Lampang cement plant said that during every team meeting at every level, each participant has an opportunity to mention an action that links to one of the corporate values or Lampang commitments. This was his way of keeping the culture values alive in the minds of managers and employees.

Employee buy-in to the corporate values and sustainability development seems almost total. Another manager said the strong culture was obvious to him because there was "little disagreement anymore about making decisions that favor environmental sustainability. Everyone is for it. People who do not buy-in to sustainable development are not fired because they leave on their own. They just aren't comfortable here."

Leadership Challenges

Daniel Anuwat continued his story. "SCG leaders have done a remarkable job developing a strong culture and values for sustainability. We have a reputation as a top progressive company in Thailand and are the employer of choice for millennials. Determined to follow King Bhumibol Adulyadej's philosophy of sufficiency economy, SCG top managers visited Huai Hong Khrai Royal Development Study Centre to learn how to reforest in a mountainous area. This is the place where the King had financed a pilot program with four check dams, and the results were remarkable. The dry season did not cause its usual damage in that forest.

"We initially approached four villages in our area. Our approach was for our community relations person to talk with each headman. The headman would let villagers know that we wanted to talk with them and arranged a village meeting. Well, not many people showed up at the meetings. We made a presentation and when we finished the people did not respond. They just sat there. We did not know what they were thinking.

"We spent some time later on revisiting the headmen and talking privately with employees who lived in the villages. We learned a bit about why the local people were so unwilling to participate.

"There were also religious beliefs causing villagers to not participate with us. One belief that stands out for me was that blocking the flow of water would block the flow of spirits in the forest. The forest should be left as it is. Let nature be nature.

"Another headman said that people were against the project because people 'cannot see the water.' They cannot imagine the pools of water and a thriving forest and the benefits. We explained all the benefits in our presentations and even showed some pictures, but they are not getting the picture, so to speak.

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"One incident was pretty scary. Supposedly, a monk who was also a headman had a gun pulled on him for speaking in support of SCG's check dam project. Apparently, a shot was fired. No one was hurt. That kind of incident is so rare that, if true, it means someone had very strong feelings against our project.

"Personally, I think check dams and reforestation in some way threatens their way of life. They burn their crop residue at the end of a growing period. They burn the forest when they feel the need. Forest fires are common during the dry season. These people are not completely wrong because a fire can produce short-term benefits for hunting and germination of bamboo and other plants. Moreover, a fire makes it easier to clear some new land for planting.

"Now I have this letter from the NGO insisting that we stop our efforts toward reforestation. NGOs try to help villagers in fundamental ways, but NGOs sometimes come up with crazy ideas. I will have to investigate this.

"I think I know one way to cut though a lot of this villager resistance. One of our employees suggested that we just pay the villagers for building the check dams. We could hire them to do a job. That is what other companies have done when they wanted village participation. The people understand payments. We would not have to engage their hearts and minds in the process. Just pay them. I discussed it with the community relations manager and a few other managers. Some are reluctant, saying that payment would destroy the community ownership we are trying to develop. I understand their point, but money would overcome a lot of resistance. A payment of 2000 baht (about $60) per check dam would buy a lot of cooperation. You can see that I am frustrated. I feel like I am letting down SCG's reputation. I am out of ideas about how to overcome their resistance and get villagers to buy-in to check dams and reforestation.

"Do you have any suggestions for gaining community buy-in?"

Questions

1. Do you support the idea of paying villagers to build check dams? Why?
2. Other than paying villagers, what other approaches should the Lampang managers take to overcome the villagers' resistance to change regarding the check dams?
3. How did SCG implement a corporate culture that strongly supports CSR and sustainability? Discuss.
4. How do you think a national sufficiency economic philosophy might have affected SCG's approach to sustainability? Explain.

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INTEGRATIVE CASE 8.0
Costco: Join the Club

Following high school, James Sinegal worked for discount warehouse Fed Mart unloading mattresses. Then, in the 1970s as an employee of California-based Price Club, he absorbed every detail of the high-volume, low-cost warehouse formula pioneered by Sol Price.

Armed with knowledge and ideas, Sinegal partnered with Jeffrey Brotman to establish Costco Wholesale Corporation. The duo opened their first store in Seattle in 1983 and rocked the business world by being the first company to go from zero to $3 billion in sales in under six years. Today, after more than 30 years in business, Sinegal's vision and success not only eclipsed those of his mentor but led to the merger of Costco and Price Club.

No Frills

With its reputation for rock-bottom pricing and razor-thin profit margins, Costco is the nation's second-largest retailer (behind Walmart) and the number-one membership warehouse retailer with 770 stores (531 in the United States), 245,000 employees, and 94 million members. Between 2009 and early 2013, sales zoomed 39 percent, reaching $105 billion for the fiscal year 2013, reflecting, in part, a consumer tendency in a poor economy to focus on value, but more significantly a unique corporate culture that gives not only lip-service to the value of employees but also maintains a reputation for honoring that value. The retailer currently ranks 12th among the top 50 Most Admired Companies in the world (*Fortune)*. In 2018, the company had over $140 billion in revenue, a whopping 9.73 percent increase over 2017.

The no-frills warehouse club concept exemplifies the much-maligned "big-box" store—merchandise stacked floor to ceiling on wooden pallets, housed in 150,000 square footage of bare concrete, and illuminated by fluorescent lighting. Customers flash membership cards and push oversized carts or flatbeds down wide aisles unadorned by advertising or display. Costco reflects industry standards and consumer expectations for providing limited selection, volume buying, and low pricing.

Valuing People

Costco's current CEO, Craig Jelinek, who took over the top job in 2012, has vowed to continue Sinegal's philosophy. The owners believe the secret to Costco's success lies in the many ways the company ventures from the norm by overturning conventional wisdom. Because the owners view people as the organization's "competitive edge," labor and benefits comprise 70 percent of Costco's operating costs. Despite Wall Street criticism, the company maintains its devotion to a well-compensated workforce and scoffs at the notion of sacrificing the wellbeing of employees for the sake of profits. The 2010 Annual Report declares, "With respect to expenses relating to the compensation of our employees, our philosophy in not to seek to minimize the wages and benefits they earn. Rather, we believe that achieving our longer-term objectives of reducing turnover and enhancing employee satisfaction requires maintaining compensation levels that are better than the industry average." The report admits Costco's willingness to "absorb costs" of higher wages that other retailers routinely squeeze from their workforce. As a result, what the company lacks in margin per item, management believes it makes up in volume, in maintaining "pricing authority by consistently providing the most competitive values," and in purchased loyalty memberships, which, as Sinegal once pointed out, "locks them into shopping with you". The formula works. Ninety percent of Costco members renew their subscriptions.

Jelinek, like Sinegal before him, is a no-nonsense CEO whose annual salary is a fraction of the traditional pay for large corporate executives (28 times compared to 380 times that of the average employee) and reflects an organizational culture that attempts to minimize disparity between management and workers. Luxury corporate offices are out of the question. Almost 70 percent of warehouse managers started out ringing cash registers or pushing warehouse carts, and the company both cultivates and sponsors future management from within by sponsoring employees through graduate school. Employees feel a connection with those who rose to management jobs, and the reverse is also true. Even top managers dress in casual attire, wear nametags, answer their own phones, and spend a significant amount of time on the warehouse sales floor.

This unorthodox employer–employee relationship is in sharp contrast to the industry norm, with employees in most companies feeling the added stress of infrequent site visits by suited corporate executives. During an interview with ABC's news magazine "20/20" in 2006, Sinegal provided a simple explanation for the frequency of warehouse visits. "The employees know that I want to say hello to them." Indeed, Costco

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employees marveled at the former CEO's ability to remember names and to connect with them as individuals. It is that "in the trenches together" mindset that defines Costco's corporate culture, contributing to a level of mutual support, teamwork, empowerment, and rapid response that can be activated for confronting any situation. A dramatic example occurred when employees instantly created a Costco emergency brigade, armed with forklifts and fire extinguishers, whose members organized themselves and rushed to offer first aid and rescue trapped passengers following the wreck of a commuter train behind a California warehouse store.

Costco's benevolent and motivational management approach manifests itself most dramatically in wages and benefits. Employees sign a one-page employment contract and then join coworkers as part of the best-compensated workforce in retail. Average hourly wages of $21.00 smash those of competitors ($10 to $11.50 per hour). Rewards and bonuses for implementation of time-saving ideas submitted by an individual employee can provide up to 150 shares of company stock. In addition, employees receive a generous benefits package including healthcare for both full-time and part-time employees (82 percent of premiums are paid by the company), as well as 401(k) retirement plans. In 2009, as the recession deepened and most employers slashed jobs and salaries, Costco CFO Richard Galanti, recalls Sinegal's exact words: "This economy is bad. [But] we should be figuring out how to give them more, not less."

Costco's generosity to employees flies in the face of industry and Wall Street conventional wisdom whereby companies attempt to improve profits and shareholder earnings by keeping wages and benefits low. Yet Sinegal insisted that the investment in human capital is good business. "You get what you pay for," he asserted and Jelinek agrees. "If you treat consumers with respect and treat employees with respect, good things are going to happen to you," Jelinek says. Among his efforts, he has urged Congress to raise the minimum wage for all workers. As a result, Costco enjoys the reputation of a loyal, highly productive workforce, and store openings attract thousands of quality applicants.

By turning over inventory rather than people, Costco can boast an annual employee turnover of only five percent, compared to retail's dismal 50 percent average. Taking into account the cost of worker replacement (1.5 to 2.5 times the individual's annual salary), the higher wages and benefits package pays off in the bigger picture with higher retention levels, a top-quality workforce, low shrinkage from theft (0.2 percent), and greater sales per employee. The combination results in increased operating profit per hour. Whether used for attracting customers or employees, the need for PR or advertising is nonexistent. Sinegal told ABC in the 2006 interview that the company doesn't spend a dime on advertising, as it already has over 140,000 enthusiastic ambassadors scattered through Costco's warehouses (today that number of enthusiastic employees is around 245,000).

Design to Fit

Equal care has been given to organization design. Sinegal's belief in a "flat, fast and flexible" organization encouraged de-facto CEO designation for local warehouse managers. Local managers have the freedom and authority to make quick, independent decisions that suit local needs of customers and employees. The only requirement is that any decision must fit into the organization's five-point code of ethics. Decisions must be lawful, serve the best interests of customers and employees, respect suppliers, and reward shareholders. Likewise, employee training places a high priority on coaching and empowerment over command and control.

All of this fits together in a culture and structure in which the focus on meeting customer needs goes beyond rock-bottom pricing. Costco's new store location efforts seek "fit" between the organization and the community it serves. Typical suburban locations emphasize the bulk shopping needs of families and small businesses, and Costco has extended its own private label, Kirkland signature. While other companies downsize or sell their private labels, Costco works to develop Kirkland, which now accounts for approximately 400 of Costco's 4,000 in-stock items. The private label provides additional savings of up to 20 percent off products produced by top manufacturers, such as tires by Michelin specifically for the Kirkland label. Additional efforts to better meet the needs of customers contributed to Costco's decision to run select stores as test labs. Over the past decade, selected Costco stores paved the way for launching a variety of ancillary businesses, including pharmacies, optical services, and small business services to better serve the needs of the company's suburban customers. Recently, the company also launched Costco Grocery for same day fresh delivery or two-day "shelf stable" produce.

Meanwhile, urban Costco locations acknowledge the customer's desire to purchase in bulk while also serving the upscale shopping desires of condo-dwellers. In these locations, the urgency to "purchase before it's gone" tempts consumers into treasure hunts with special deals on luxury items such as Dom Perìgnon Champagne, Waterford crystal, or Prada watches.

The rapid growth of Costco from one store in Seattle to America's warehouse club leader and global retailer has come with a share of growing pains as the organization attempts to adapt to its various environments. The merger with Price Club brought an infusion of unionized workers, forcing owners and management officials to push Costco's "superior" wages and benefits as a way to negate the need for unionization.

New Issues

Costco's own reputation for high ethical standards and self-regulation has, in the face of rapid expansion, come up against a myriad of new problems ranging from complaints about a lack of notification for management job openings

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to persistent complaints of a glass-ceiling that provides few opportunities for the advancement of women within the organization. In response, the company instituted online job postings, automated recruiting, the use of an outside vendor for hiring, and a recommitment to equity in promotion.

International issues are often more complex and often run up against local needs and perceptions. For example, efforts to expand into Cuernavaca, Mexico, were viewed from the company perspective as a win-win situation, opening a new market and providing jobs and high-quality, low-priced items for area shoppers. When the site of a dilapidated casino became available, Costco moved quickly but suddenly found itself facing charges of cultural insensitivity in Mexico. Accusations in Cuernavaca that Costco was locating a parking lot over an area with significance in artistic and national heritage led to negotiations under which Costco set aside millions of dollars to preserve, landscape, restore murals, and work alongside city planners and representatives of the Mexican Institute of Fine Arts and Literature in the building of a state-of-the-art cultural center and museum.

The story illustrates the emphasis on moral leadership that has come to characterize Costco and its senior management. Business decisions based strictly on financial terms take a back seat to success based on broader criteria: Are we creating greater value for the customer? Are we doing the right thing for employees and stakeholders? Management believes that the answers to these broader questions help keep the company relevant to the issues and trends shaping the future of business.

Among those trends: increased global corporate ESG (environmental, social, and governance) concerns, how the growing momentum for minimum wage increases across states will affect Costco's wage advantage, and the impact of Internet retail.

The company already feels that many companies are having to play "catch-up" in the area of ESG. Costco has worked hard to improve its carbon footprint with sustainability efforts that lower costs of water and energy consumption and address issues such as food waste and safety (for example, farmed salmon versus wild salmon). By focusing money and attention on ESG issues, management believes the short-term cost is balanced by long-term benefit in reputation, customer and employee service, and profitability.

One area in which Costco has surprised competitors and Wall Street is Internet sales. In 2018, its first year in the Internet retail category, Costco shocked the business world by topping Amazon as the new "king of Internet sales," posting an ACSI (American Consumer Satisfaction Index) score of 83 compared to Amazon (leader since 2011), which scored 82. Pundits noted "the expansion in the Internet category (with the addition of Etsy, Kohl's, Nike, Macy's, Apple, and others) makes Costco's top-ranking performance all the more impressive."

Indications are bright for Costco's future, but questions loom on the horizon. Everyone, from Wall Street pundits to customers, shareholders, and employees is still wondering how the organization might change and adapt to future challenges. So far, things look good, but will future leaders be willing to maintain the modest levels of compensation for top management and maintain the company's above average wages and benefits for employees? And how will expanding globalization alter the strong corporate culture?

Questions

1. Describe the culture at Costco. How do you think the culture contributes to Costco's success?
2. How does Costco motivate its employees? Would you like to work at Costco? Why?
3. What environmental issues must Costco deal with?
4. In what ways does Costco try to be a socially responsible company?

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INTEGRATIVE CASE 9.0

The Donor Services Department*

Joanna Reed was walking home through fallen tree blossoms in Guatemala City. Today, however, her mind was more on her work than the natural beauty surrounding her. She unlocked the gate to her colonial home and sat down on the porch, surrounded by riotous toddlers, pets, and plants, to ponder the recommendations she would make to Sam Wilson. The key decisions she needed to make about his Donor Services Department concerned who should run the department and how the work should be structured.

Joanna had worked for a sponsorship agency engaged in international development work with poor people for six years. She and her husband moved from country to country setting up new agencies. In each country, they had to design how the work should be done, given the local labor market and work conditions.

After a year in Guatemala, Joanna, happily pregnant with her third child, had finished setting up the Donor Services Department for the agency and was working only part-time on a research project. A friend who ran a "competing" development agency approached her to do a consulting project for him. Sam Wilson, an American, was the national representative of a U.S.-based agency that had offices all over the world. Sam wanted Joanna to analyze his Donor Services Department, because he'd received complaints from headquarters about its efficiency. Since he'd been told that his office needed to double in size in the coming year, he wanted to get all the bugs worked out beforehand. Joanna agreed to spend a month gathering information and compiling a report on this department.

Sponsorship agencies, with multimillion-dollar budgets, are funded by individuals and groups in developed countries who contribute to development programs in less-developed countries (LDCs). Donors contribute approximately $20.00 per month plus optional special gifts. The agencies use this money to fund education, health, community development, and income-producing projects for poor people affiliated with their agency in various communities. In the eyes of most donors, the specific benefit provided by sponsorship agencies is the personal relationship between a donor and a child and his or her family in the LDC. The donors and children write back and forth, and the agency sends photos of the child and family to the donors. Some donors never write the family they sponsor; others write weekly and visit the family on their vacations. The efficiency of a Donor Services Department and the quality of their translations are key ingredients to keeping donors and attracting new ones. Good departments also never lose sight of the fact that sponsorship agencies serve a dual constituency—the local people they are trying to help develop and the sponsors who make that help possible through their donations.

What Is a Donor Services Department in a Sponsorship Agency Anyway?

The work of a Donor Services Department consists of more than translating letters, preparing annual progress reports on the families, and answering donor questions directed to the agency. It also handles the extensive, seemingly endless paperwork associated with enrolling new families and assigning them to donors, reassignments when either the donor or the family stops participating, and the special gifts of money sent (and thank you notes for them). Having accurate enrollment figures is crucial because the money the agency receives from headquarters is based upon these figures and affects planning.

The Department Head

Joanna tackled the challenge of analyzing the department by speaking first with the department head (see the organizational chart in Exhibit 1). José Barriga, a charismatic, dynamic man in his 40s, was head of both Donor Services and Community Services. In reality, he spent virtually no time in the Donor Services Department and was not bilingual. "My biggest pleasure is working with the community leaders and coming up with programs that will be successful. I much prefer being in the field, driving from village to village talking with people, to supervising paperwork. I'm not sure exactly what goes on in Donor Services, but Elena, the supervisor, is very responsible. I make it a point to walk through the department once a week and say hello to everyone, and I check their daily production figures."

The Cast of Characters in the Department

Like José, Sam was also more interested in working with the communities on projects than in immersing himself in the details of the more administrative departments. In part, Sam had contracted Joanna because he was rightfully worried that Donor Services did not receive the attention it deserved from José, who was very articulate and personable but seldom had time to look at anything beyond case histories. José never involved himself in the

* Joyce S. Osland, San Jose State University.

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internal affairs of the department. Even though he was not considered much of a resource to them, he was well liked and respected by the staff of Donor Services, and they never complained about him.

The Supervisor

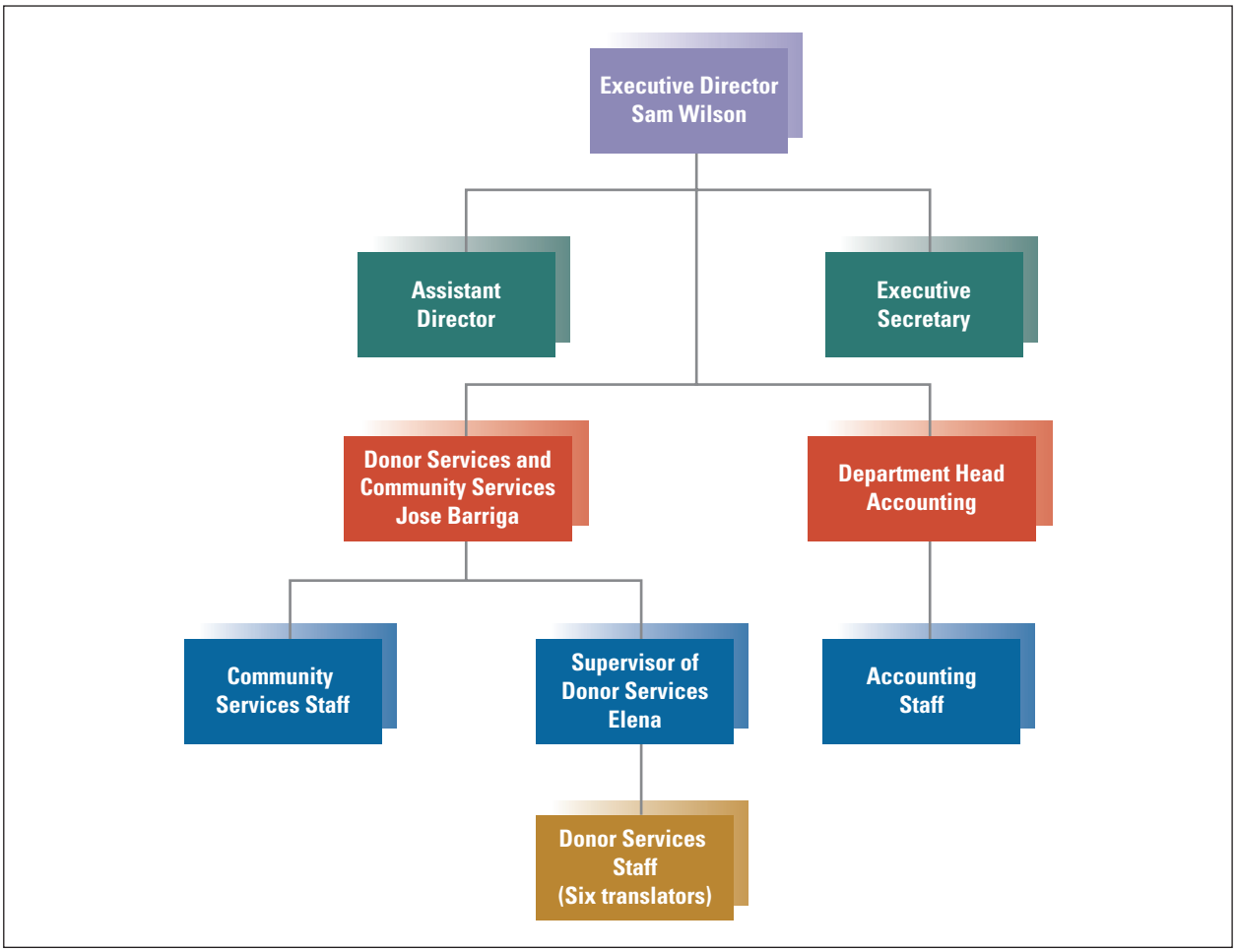
This was not the case with the supervisor José had promoted from within. Elena had the title of departmental supervisor, but she exercised very little authority. A slight, single woman in her 30s, Elena had worked for the organization since its establishment ten years earlier. She was organized, meticulous, dependable, and hard working. But she was a quiet, non-assertive, nervous woman who was anything but proactive. When asked what changes she would make if she were the head of the department, she sidestepped the question by responding, "It is difficult to have an opinion on this subject. I think that the boss can see the necessary changes with greater clarity."

Elena did not enjoy her role as supervisor, which was partly due to the opposition she encountered from a small clique of long-time translators. In the opinion of this subgroup, Elena had three strikes against her. One, unlike her subordinates, she was not bilingual. "How can she be the supervisor when she doesn't even know English well? One of us would make a better supervisor." Bilingual secretaries in status-conscious Guatemala see themselves as a cut above ordinary secretaries. This group looked down on Elena as being less skilled and educated than they were, even though she was an excellent employee. Second, Elena belonged to a different religion than the organization itself and almost all the other employees. This made no difference to Sam and José but seemed important to the clique, who could be heard making occasional derogatory comments about Elena's religion.

The third strike against Elena was her lack of authority. No one had ever clarified how much authority she really possessed, and she herself made no effort to assume control of the department. "My instructions are to inform Don José Barriga of infractions in my daily production memo. I'm not supposed to confront people directly when infractions occur, although it might be easier to correct things if I did." ("Don" is a Latin American honorific used before the first name to denote respect.)

EXHIBIT 1

Organizational Chart—Donor Services Department



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This subgroup showed their disdain and lack of respect for Elena by treating her with varying degrees of rudeness and ignoring her requests. They saw her as a watchdog, an attitude furthered by José who sometimes announced, "We (senior management) are not going to be here tomorrow, so be good because Elena will be watching you." When Sam and José left the office, the clique often stopped working to socialize. They'd watch Elena smolder out of the corners of their eyes, knowing she would not reprimand them. "I liked my job better before I became supervisor," said Elena. "Ever since, some of the girls have resented me, and I'm not comfortable trying to keep them in line. Why don't they just do their work without needing me to be the policeman? The only thing that keeps me from quitting is the loyalty I feel for the agency and Don José."

The Workers

In addition to the clique already mentioned, there were three other female translators in the department. All the translators but one had the same profile: in their 20s, of working-class backgrounds, and graduates of bilingual secretary schools, possessing average English skills. (As stated earlier, in Latin America, being a bilingual secretary is a fairly prestigious occupation for a woman.) The exception in this group was the best translator, Magdalena, a college-educated recent hire in her late 30s who came from an upper-class family. She worked not because she needed the money but because she believed in the mission of the agency. "This job lets me live out my religious beliefs and help people who have less advantages than I do." Magdalena was more professional and mature than the other translators. Although all the employees were proud of the agency and its religious mission, the clique members spent too much time socializing and skirmishing with other employees within and without the department.

The three translators who were not working at full capacity were very close friends. The leader of this group, Juana, was a spunky, bright woman with good oral English skills and a hearty sense of humor. A long-time friend of Barriga's, Juana translated for English-speaking visitors who came to visit the program sites throughout the country. The other translators, tied to their desks, saw this as a huge perk. Juana was the ringleader in the occasional mutinies against Elena and in feuds with people from other departments. Elena was reluctant to complain about Juana to Barriga, given their friendship. Perhaps she feared Juana would make her life even more miserable.

Juana's two buddies (*compañeras*) in the department also had many years with the agency. They'd gotten into the habit of helping each other on the infrequent occasions when they had excessive amounts of work. When they were idle or simply wanted to relieve the boredom of their jobs, they socialized and gossiped. Juana in particular was noted for lethal sarcasm and pointed jokes about people she didn't like. This clique was not very welcoming to the newer members of the department. Magdalena simply smiled at them but kept her distance, and the two younger translators kept a low profile to avoid incurring disfavor. As one of them remarked, "It doesn't pay to get on Juana's bad side."

Like many small offices in Latin America, the agency was located in a spacious former private home. The Donor Services Department was housed in the 40 × 30-foot living room area. The women's desks were set up in two rows, with Elena's desk in the back corner. Since the offices of both Wilson and Barriga were in former back bedrooms, everyone who visited them walked through the department, greeting and stopping to chat with the long-time employees (Elena, Juana, and her two friends). Elena's numerous visitors also spent a good deal of time working their way through the department to reach her desk, further contributing to the amount of socializing going on in the department.

Elena was the only department member who had "official" visitors since she was the liaison person who dealt with program representatives and kept track of enrollments. The translators each were assigned one work process. For example, Marisol prepared case histories on new children and their families for prospective donors, while Juana processed gifts. One of the newer translators prepared files for newly enrolled children and did all the filing for the entire department (a daunting task). Most of the jobs were primarily clerical and required little or no English. The letter translations were outsourced to external translators on a piece-work basis and supervised by Magdalena. Hers was the only job that involved extensive translation; for the most part, however, she translated simple messages (such as greeting cards) that were far below her level of language proficiency. The trickier translations, such as queries from donors in other countries, were still handled by Wilson's executive secretary.

Several translators complained that, "We don't have enough opportunity to use our English skills on the job. Not only are we not getting any better in English, we are probably losing fluency because most of our jobs are just clerical work. We do the same simple, boring tasks over and over, day in and day out. Why did they hire bilingual secretaries for these jobs anyway?"

Another obvious problem was the uneven distribution of work in the office. The desks of Magdalena and the new translators were literally overflowing with several months' backlog of work, while Juana and her two friends had time to kill. Nobody, including Elena, made any efforts to even out the work assignments or help out those who were buried. The subject had never been broached.

The agency was growing at a rapid pace, and there were piles of paperwork sitting around waiting to be processed. Joanna spent three weeks having each department member explain her job (in mind-numbing detail), drawing up flow charts of how each type of paperwork was

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handled, and poking around in their files. She found many unnecessary steps that resulted in slow turnaround times for various processes. There were daily output reports submitted to Barriga, but no statistics were kept on the length of time it took to respond to requests for information or process paperwork. No data were shared with the translators, so they had no idea how the department was faring and little sense of urgency about their work. The only goal was to meet the monthly quota of case histories, which only affected Marisol. Trying to keep up with what came across their desks summed up the entire focus of the employees.

Joanna found many instances of errors and poor quality, not so much from carelessness as lack of training and supervision. Both Barriga and Wilson revised the case histories, but Joanna was amazed to discover that no one ever looked at any other work done by the department. Joanna found that the employees were very accommodating when asked to explain their jobs and very conscientious about their work (if not the hours devoted to it). She also found, however, the employees were seldom able to explain why things were done in a certain way, because they had received little training for their jobs and only understood their small part of the department. Morale was obviously low, and all the employees seemed frustrated with the situation in the department. With the exception of Magdalena, who had experience in other offices, they had few ideas for Joanna about how the department could be improved.

Questions

1. What do you consider the major problem in this Sponsorship Agency? Explain.
2. What is the level of intergroup conflict? What is its cause?
3. What do you recommend to help the Donor Services Department become more effective?
4. How might greater empowerment help the situation in the Donor Services Department? What specifically would you change to achieve greater empowerment?

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INTEGRATIVE CASE 10.0

Cisco Systems: Evolution of Structure

The evolution of Cisco from a university campus computer networking solution devised by the husband/wife Stanford team of Len Bosack and Sandy Lerner to a global technology leader has been a dynamic process. The speed of technological innovation means that managers are already talking about the "next new thing" during the launch of each new product or service. Parallel with the rapid technological evolution of Cisco have been the changes in organizational structure necessary to meet the management and decision-making needs of the corporate giant.

Growth

Faced with the challenge of devising a system allowing Stanford computer networks to talk to each other, Bosack and Lerner created a multiprotocol router to break through the communication barriers. The perceived need by many organizations for increasingly sophisticated routers and related products led to the founding of the Silicon Valley hi-tech powerhouse Cisco in 1984. As a startup company, Cisco had a vision, eight employees, and a host of financial challenges. The early days were financed by credit cards, home mortgages, and periods when payrolls were delayed, but in 1986, Cisco shipped its first router. The company turned to a venture capitalist, Sequoia Capital, which moved Cisco toward financial stability, but founders Bosack and Lerner were forced out and replaced with new management. Cisco quickly became established as a viable business and, armed with a growing reputation in the industry, went public in 1990.

A leader in the development of routers, Cisco faced new challenges with the emergence of competitors for rapid, less-expensive technology. Facing the threat of losing high-profile customers and industry leadership, Cisco management took a bold move in its innovation strategy through the acquisition of small innovative companies such as Crescendo Communications, a company that had attracted the attention of major customers including Boeing.

Cisco was selective in its acquisitions, focusing on small startup companies that were working on a great product that could be moved from development into production within 6-12 months. The company's goal was to *purchase the future* by acquiring the engineers who were working on the *next generation* of products and services. Therefore, the retention of employees was critical to a successful acquisition. For its part of the deal, Cisco could offer the startup the power of Cisco's financial resources, manufacturing, and distribution channels. Cisco's reputation for finding and bringing into the fold the best of the smaller companies reminded admirers and critics alike of *the Borg,* the notorious alien being from Star Trek fame that absorbed species as it expanded across the universe.

As Cisco expanded into wireless devices for home (Linksys) and business, data center switching systems, networking equipment, communications gear, and network security apparatus, visionary John Chambers was brought in as CEO. One of a generation of gurus who championed the power and practical solutions of technology, Chambers expanded the company into advanced technologies including digital voice and data, web-conferencing, and more diverse security products. By 2000, Cisco had attained a brief designation as the world's most valuable company.

Cisco 1

During the early period that would later become designated as Cisco 1, the organization had created a three-division organizational structure. The three self-contained product divisions were each focused on a distinct customer segment: Service Products (such as AT&T), Enterprises (usually multinational corporations), and Small to Mid-Size Commercial Enterprises. Each of the three divisions had its own engineering, manufacturing, and marketing functions. Goals were established by each division's managers to develop products and services customized to address the specific and changing needs within that customer group.

With corporate headquarters in San Jose and a dominance of U.S. sales, Cisco found that it could minimize costs with a move toward outsourcing manufacturing to contract manufacturers from within each of the divisions. Cisco had, in effect, a structure wherein managers were rewarded for the performance of their own division. Flexibility and coordination occurred across the functional departments within each division, but there was little collaboration across the three divisions. This decentralized structure seemed to work fine in a prosperous and rapidly growing company.

What a difference a year can make. In 2001, one year after a brief designation as the world's most valuable company, a sharp economic downturn hit Cisco and other companies in the high-tech industry. The techno bubble of the 1990s had burst. Across Silicon Valley, tech stocks tumbled, layoffs proliferated, and companies struggled to adjust and survive. At the

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same time, increasing product complexity and technical advancement within the field pushed management at Cisco to reconsider whether the existing divisional organizational structure was sufficient to carry the company into the future.

Cisco 2

Reviewing the three-division structure, Chambers and his management team detected serious overlap in the work of functional departments across product divisions. One glaring example was the overlap of engineering groups in each of the three divisions who were all working on similar products without knowing it. This was a huge excess of engineering talent focused on relatively straightforward new products. The lack of communication across the three divisions created a lack of awareness and cooperation necessary for finding shared solutions, avoiding repetition, and speeding the process time required to introduce a new product. Likewise, the complete independence and separation of each division resulted in a glut of separate vendors and suppliers for the division in addition to the duplication of employees working on similar projects—all of which added to company costs.

In order to address the need for efficient use of resources while trying to meet the need for new products and geographic expansion, the company moved toward a functional structure. Changes came swiftly in the move to streamline operations and bring costs down. Between 2001 and 2006, the company moved through the reorganization, designated Cisco 2, cutting the workforce by 8,000 employees, reducing the number of vendors (1,500 to 200) and suppliers (600 to 95), and trimming outsourced manufacturing from 13 major plants to four. The company's costs as well as overlap were further cut as the major functions of sales, accounting, and engineering were combined into single large centralized groups that reported to headquarters. The three separate and autonomous divisions were gone. The huge engineering staff was broken into 11 functional groups that reflected the core technologies on which they worked, resulting in added efficiency and reduced overlap.

Cisco 2 provided senior management of each function much vertical control over the work of their engineers, salespeople, etc. Top managers could set goals and expect to achieve those goals, along with performance bonuses, because of direct control over their functional departments and the projects on which employees worked. Cisco became much more efficient with fewer people needed within each function, but it was also becoming more hierarchical and encountered new coordination problems because each functional department became more like a separate silo, with people focused on their own function's goals and projects with little concern for the needs of other groups.

Cisco 3

By 2006, expanded globalization and product lines and the continued need and movement toward horizontal collaboration brought further structural evolution, called Cisco 3. Cisco 3 was an attempt to move from a traditional top-down hierarchical structure to a more amorphous structure built around horizontal committees. The new structure, shown in Exhibit 1, added 12 business councils at the senior level, 1 for each key customer segment. Each council was composed of approximately 14 executive VPs and senior VPs—roughly one from each major function. The intention of the new structure was to instill a culture of collaboration that would provide better horizontal coordination across functions. The business councils worked at the policy level, involving representatives from each function to select and coordinate new programs and speed products to market in their segment.

Beneath the business council level, 47 boards were created to align cross-functional teams below the vice president level. Each board consisted of about 14 people and included one VP and senior VP. Board members would collaborate across functions to implement the new product decisions from the councils.

Beneath the boards, temporary working groups were created of up to 10 people each as needed to execute the details of new product and project implementation in the short term. Having three levels of matrix-type horizontal relationships built into Cisco's structure was viewed as a better way to address a complex environment characterized by uncertainty and rapid change by providing the internal teamwork, coordination, and information-sharing needed for continuous innovation.

The twenty-first century tech giant's structural evolution brought difficult cultural adjustments. While growth and performance targets remained, emphasis was now placed on collaboration to find solutions for customer needs by involving people from other functions. Executive compensation changed from achieving one's own department's goals to achieving cooperation with other departments, and bonuses for some senior executives, as Chambers admits, "went poof." With performance no longer dependent solely on hitting targets within a tightly controlled function, the organization experienced initial executive resistance to giving up control, to sharing information and resources, and to joint decision making. The new focus for performance evaluation was on peer review ratings based on successful teamwork. Chambers estimates a loss of approximately 20 percent of top management who "couldn't make the transition" to collaborative work, including the development chief, the senior VP for routers and service provider networks, and the mergers and acquisitions chief. But the new structure eventually fell into place as its benefits became apparent, and Cisco successfully rode the loss of key managers.

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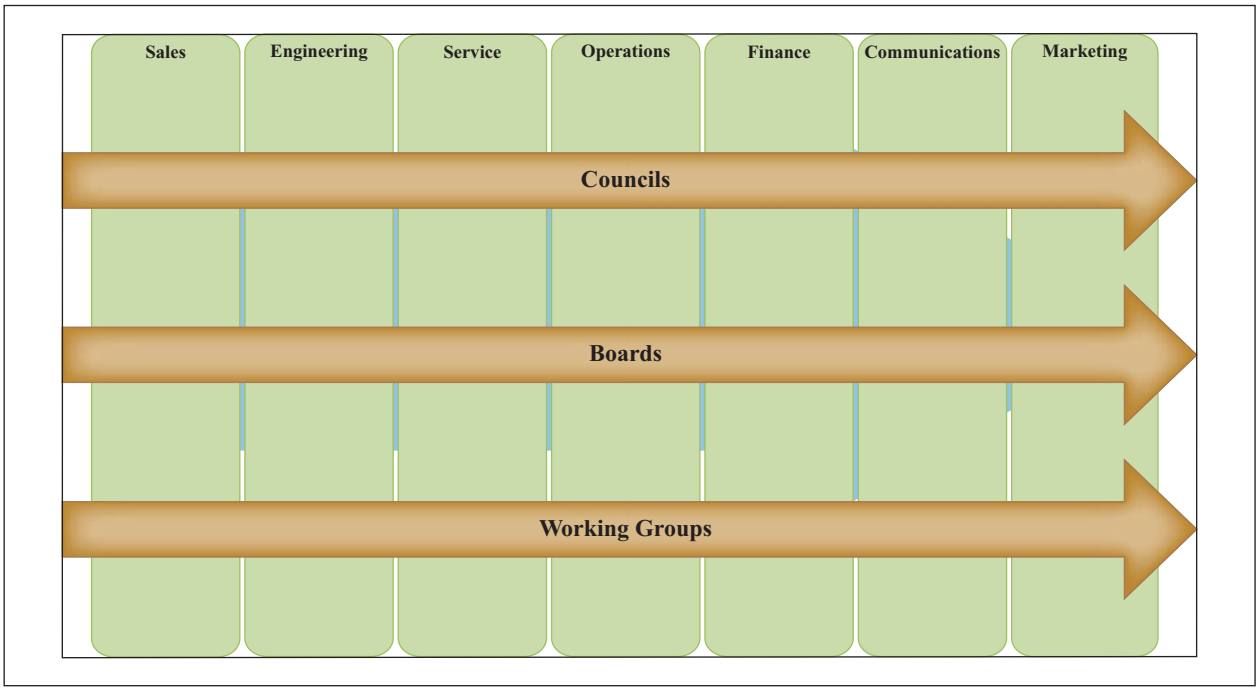
EXHIBIT 1
Cisco Functional Structure with Cross-Functional Committees



Sources: Ranjay Gulati, Allison Berkeley Wagonfield, and Luciana Silvestri, "Cisco in 2012: Reorganizing for Efficiency and Flexibility," Teaching Case 9-413-069, August 30, 2014. Copyright 2014 President and Fellows of Harvard College; and Ranjay Gulati, "Cisco Business Councils (2007): Unifying a Functional Enterprise with an Internal Governance System," Teaching Case 9-409-062, June 11, 2010. Copyright 2010 President and Fellows of Harvard College.

The structure continued to evolve and streamline as Cisco evolved. Five years later, in 2011, the number of business councils had been reduced to 3 and the number of boards to 15. This was sufficient to make collaborative decisions on key new products for customer segments. Over time Cisco's top management saw the need to reduce the number of business councils from 12 to 9 and then to 3. Cisco also slashed the number of internal boards and working groups because managers grumbled about the staggering number of boards and council meetings taking up their time.

Simultaneously, Cisco planned to further strengthen the coordination across functions and departments by tapping into social media. In 2006, the company execs began using TelePresence, a system of lifelike videoconferencing, to connect customers and colleagues around the globe. Then, with the introduction of *Ciscopedia*, the organization allowed a greater level of information sharing and consultation between employees and among members of the remaining business councils and boards. Employees use social media, blogs, video, and bookmarking to post ideas, coordinate teams, share information, and avoid duplication across departments, product lines, and geographic areas.

Corporate Culture

Cisco got serious about implementing a successful organizational culture around the year 2000. It carried out a survey among 5,000 employees from technology companies around the world in 2001. The survey indicated five characteristics associated with a successful Internet culture:

1. Strong, visible leadership.
2. Customer-centric approach.
3. Work environment with a feeling of collective ownership.
4. A system of networked communications with real-time responsiveness.
5. Innovation processes that enable risk taking and disciplined execution.

The organization philosophy of Cisco fostered employee involvement. People were encouraged to work directly with people in other areas without passing through every layer of management. To get support for an innovative idea, an employee had to discuss it with an employee decision-making team and get its approval. If the decision-making team accepted the idea, top management would give the green light. The teams were empowered to make the decision.

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Another example of the empowerment culture was that any employee, with the permission of the superior, could reward any other employee with an on-the-spot bonus ranging from a free dinner to as much as $2,000. Cisco employees were encouraged to go ahead with their ideas. Cisco lived by the empowering motto "Don't ask for permission, ask for forgiveness later."

Cisco stood out as a corporation having an excellent record of accomplishment in implementing the acquisitions of other companies, which required merging the two cultures in a way that retained acquired employees, an important asset. Cisco had a 98 percent retention rate among key personnel during acquisitions. Implementation involved making new employees aware of Cisco's history and addressing concerns of new employees.

An open door policy was another feature of Cisco's culture. Employees could discuss business matters in an informal manner. Micromanagement was rare.

Fun outside the job was also encouraged at Cisco. Cisco would hire a circus, Cirque du Soleil, and local rock DJs to perform exclusively for employees. It also conducted Christmas parties and myriad entertainment events.

Cisco's current culture and values statement is shown in Exhibit 2. The six values show the importance of being an outstanding company through collaborative efforts, mutual respect, and high ethical standards.

Corporate Sustainability

Cisco became a pioneer with its focus on sustainability starting in the early 1990s. In 2018, Cisco was named one of the Global 100 Most Sustainable Corporations by Corporate Knights, which analyzed 7,425 companies with gross revenues of at least US $1 billion along 17 quantitative performance indicators. The top 100 companies represent the top two percent in the world on sustainability performance.

Cisco uses the power of technology and passionate employees to address global issues like unemployment, hunger, poverty, climate change, and income inequality. In 2017, 80 percent of Cisco's electricity use worldwide came from renewable sources. Cisco also reduced greenhouse gas emissions by 41 percent compared with the 2007 baseline.

Cisco's "Global Problem Solver Challenge" recognizes teams of students and recent graduates who use the Internet of Things (IoT) technologies to drive economic development, solve social and environmental problems, and promote inclusion. Cisco is committed to creating a diverse and inclusive culture. Cisco has been on the *Forbes* "Best Companies to Work For" list for 21 years running, which reflects the commitment to building a culture that values personal and professional growth. Cisco also stresses that inclusion connects diverse perspectives, challenges the status quo, and unlocks the full potential of Cisco people.

In 2017, Cisco received 26 industry distinctions and inclusive leadership awards and scored 100 percent on the Human Rights Campaign's Corporate Equality Index for the 14th consecutive year. Cisco executives know that becoming a corporate leader on diversity has to start at the top. The executive leadership team is one of the most diverse in the technology industry (46 percent diversity), demonstrating the fundamental value of inclusion.

EXHIBIT 2

Cisco Inc.'s Culture and Values Statement

Cisco Culture and Values

- **Change the World**
  - We're committed to technology innovation that connects us all. Our pride in community inspires us to give our time, knowledge, and solutions to create positive experiences that make the world a better place.
- **Focus Intensely on Customers**
  - We make customers' challenges our own. We listen to where they want to go and help transform their business. We value in-depth customer relationships and deliver superior quality solutions.
- **Make Innovation Happen**
  - We anticipate market transitions and chart a path of innovation leadership. We create relevant, meaningful solutions. We have the courage to take informed risks, simplify the complex, and pursue excellence.
- **Win Together**
  - We work smart and collaborate effectively across teams to do extraordinary things. We're passionate about ensuring customers' and partners' success and generating profitable growth for shareholders.
- **Respect and Care for Each Other**
  - We work, grow, learn, and have fun together. We support and trust one another through change. We inspire each other, celebrate diversity of thought, encourage openness, and reward for team results.
- **Always Do the Right Thing**
  - We're honest and straightforward in all our actions. We earn the trust and confidence of others. We say what needs to be said and hold ourselves accountable.

Source: Cisco, https://www.cisco.com/c/m/en_us/about/careers-home/professional-careers/consulting-services/consulting-team/culture-values.html (accessed July 8, 2019).

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Further Developments

Despite the constant structural evolution, by early 2011 Cisco was suffering through a fourth consecutive quarter of shrinking profits, with its stock price down 35 percent over a four-year period. Nervous investors watched Hewlett Packard's rapid rise to number two in global shared networking and grumbled as they also watched a three-year drop in Cisco's core areas (10 percent in routers and 11 percent in edge connecting markets). They pointed consistently to what they saw as Cisco's "reckless ventures" and complained that the boards were proving to be little more than "rubber stamps" for the CEO's wishes.

In April 2011, Chambers released an internal memo, admitting mistakes resulting in "employee confusion, disappointment among investors, and the loss of credibility in the marketplace." He called for a refocus on the core networking business, insisting Cisco's strategy was "sound." The problems, he said, were with "operational execution," with lack of accountability, slow decision making, and the inability to react to surprises. "We know we have to change," Chambers said.

Yet another structural change, five board committees covering Acquisitions, Audits, Compensation and Management Development, Finances, and Nominations/Governance were created. The problem of accountability was also addressed by a Code of Conduct, monitored by the ethics office. The goal was to become the customers' "*most trusted*" business and technology advisor. But flexibility and the *need for speed* in anticipating and capturing market transitions was equally important. The implementation of 29 performance measures was seen as a way to clarify department and team goals and keep teams focused and on track. With vision and strategy clarified, functional leaders were empowered to implement additional changes.

In October 2012, Cisco was expanding the roles and responsibilities of a number of key executives including Gary B. Moore, who was promoted to president and COO and heralded Cisco's latest moves as proof that the changes made were successfully advancing both accountability and the questions about operational discipline.

But with rapid, looming changes in networking software, by May 2014 Chambers was warning of a "brutal, brutal consolidation of the IT industry," predicting that when the smoke cleared only two or three of the major players would remain standing. With all of its structural changes, the question remained: Would Cisco be one of those still standing? Did Cisco have it right this time?

In July 2015, after 20 years at the helm, John Chambers stepped down as CEO, replaced by Chuck Robbins, who announced a diverse leadership team of Vice Presidents evenly divided with five men and five women. The transformation has been bumpy, marked by press coverage of the exodus of top executives, and anticipation that the hardware giant will continue the pace of software acquisitions (which made up 70 percent of Cisco deals from 2012 to 2017).

With Cisco's $36 billion tech portfolio, a 2018 MarketLine SWOT Analysis reported $43 million in annual revenue growth over 2017, driven by steady revenue growth in Cisco Nexus 9000 Series products/services, Cisco Catalyst 9000 Series infrastructure platforms and services (1.8 to 3 percent growth), and with more impressive gains in application products and security (10.2 percent and 9.3 percent respectively). Cisco continues to broaden its reach in software rather than hardware. Acquisitions over the past couple of years included cloud-based platforms, collaboration/conferencing, device threat protection, and security intelligence. Likewise, the company demonstrates a positive outlook for global IT in both hardware and software with partnerships providing cloud solutions to Kuwait, and the design of the network infrastructure for Expo 2020 in Dubai.

However, questions remained as the demand for traditional routers and switches declined; Cisco continued a new business model emphasizing software. Would Robbins' leadership boost morale, bring organizational stability, stem the tide of executive departures, improve delivery schedules, and shorten lead times? Could Cisco fend off competitors (Alcatel-Lucent, Amazon, and Chinese giant Huawei) as well as the emerging product-sharing deals between telecom, cable, and satellite operators? The competitive environment contains many challenges for Cisco. Its history, competitive instincts, structure, innovation processes, and strong culture would predict continued success, and investors and observers are waiting for the future to arrive.

Questions

1. Draw a simple sketch of Cisco's organization chart in both the Cisco 1 and Cisco 2 periods. Did the change to the Cisco 2 structure alleviate the problems experienced with the previous structure? Explain.
2. What new challenges would you expect to arise with the change to the Cisco 3 structure?
3. How does Cisco's corporate culture align with and support the Cisco 3 structure? Discuss where you see alignment and misalignment.
4. What is the value for a high technology Cisco to have such a strong emphasis on sustainability? Explain.

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INTEGRATIVE CASE 11.0

ToolTopia.com*

Introduction

In 2008, father-and-son entrepreneurial team Troy and Ryan Stubblefield flew down to Florida to meet with one of their leading suppliers. As the co-founders of ToolTopia, an online seller of tools, the two of them had flown around the country from their home base in Shreveport, Louisiana, to visit with clients any number of times, and there was no reason to expect this visit to be any different. As they were playing golf with the supplier, however, the discussion took an unexpected direction: the supplier offered to buy them out. ToolTopia had been in business since 2002, and the Stubblefields had invested a great deal of time and energy into making it successful. They had revised their business model more than once in the early days and had steadily built an Internet presence and a network of suppliers. The company had grown from a tiny experiment staffed by part-time employees and unpaid volunteers (i.e. members of the Stubblefield family) to a full-time job for four and a half-time job for four others. Troy, the father, and Ryan, the son, discussed the offer as they flew back to Louisiana. Should they hang onto the company that they had spent the last six years developing from nothing but an idea or should they take the supplier's offer and sell the company before larger competitors moved in? As they flew home, they thought back on the company's history and about their own careers.

Troy Stubblefield's Story

ToolTopia.com had started as an online spin-off of Shreveport Air Tools, a business Troy Stubblefield had entered in 1979 when he purchased partial ownership. Shreveport Air Tools sold air control valves, instrumentation, grinders, impact wrenches, and other equipment to the petroleum, automotive, and construction industries. The pressure gauges they sold were used for fire suppression equipment. The company had done good business in the late seventies and into the mid-1980s, but the oil bust of 1986 had been a painful experience. They had managed to survive it without going into debt, Troy said, but it was "not pretty." After that, Troy diversified into real estate, and it turned out to be a good move. The oil bust of 2015 had made a dent in their sales but had not had the same kind of catastrophic effect on his bottom line that the 1986 bust had.

In 2001, Troy had an experience that caused him to rethink his business strategy. He lost an order from one of his best customers to an online business. He had never given much thought to selling online before that. At that time, Internet businesses were still viewed as high-risk, renegade ventures. Troy said he didn't think the Internet part of his industry would ever be significant and neither did many of the other established companies. Losing one of his best customers, however, got his attention. He called his son Ryan, who was a senior business major at Louisiana Tech University, and asked him about how to set up a website. At the time his father called him, Ryan had been dabbling in website design. He had taken one course in HTML and had figured out basic hosting, but he did not consider himself to be an expert. It was simply something he enjoyed.

Launching ToolTopia

With Ryan advising him on the technology, Troy started putting together a business model. He looked at what the various products were selling for and at freight prices and got a handle on the margins. Most sellers, he found, were warehousing the equipment themselves. They charged their online customers less because they did not have the expenses associated with direct selling. Troy came up with a list of 400 SKUs (stock keeping units) for the products of two manufacturers his company already had a relationship with.

Ryan, meanwhile, had been looking into e-commerce software. He found an e-commerce platform that charged a monthly fee and spent an entire summer uploading ToolTopia's initial product list into the platform.

ToolTopia launched on Labor Day, 2002. The first product they sold, Troy says, was a $49 paint and body sander. Troy remembers what the industry was like then: "There weren't many entry barriers," he said. "It was easy to start a business, but hard to muscle into the market. You had to do battle with big players like Granger." He also said that longevity in the marketplace was important, and that it took time to build market share and to become profitable. The company had to operate at a loss for a while. "Our business model shifted several times," he said. "Nobody was an expert at the turn of the century."

Not long after its launch, ToolTopia began to use Google to expand its reach, but Troy found that people were visiting the website and leaving, and that the

* This case was written by Timothy D. Wise, DBA, Turner Professor of Management, Southern Arkansas University. The case was assembled from personal interviews with Troy, Vicki, and Ryan Stubblefield in 2015.

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company was losing money on marketing. Some of the people he talked to about his problem suggested that he become an affiliate rather than a retailer. He would take a reduced margin but reduce risk because he would not actually own the merchandise he sold. Instead, ToolTopia would serve as a centralized location customers could go to when they needed to shop for tools. Since the tool industry was highly fragmented, that was a useful service. Troy talked to manufacturers and suppliers. Ingersoll Rand said they couldn't drop ship small orders directly to customers, so Troy talked to his "warehouse guy" at Chicago Pneumatic. The last week of the month was busy for the warehouse, Troy learned, but the rest of the month was slower. Selling through ToolTopia would give the company a way to sell more during the slower weeks. Troy gave Chicago Pneumatic a prominent position on his website. Shortly afterward, someone from Ingersoll Rand called to see why their company did not have top billing on the website. Similar things happened over the next few years. Troy explained that Shreveport Air Tools had spent most of its time dealing with the end users of its products, but ToolTopia's employees mainly dealt with suppliers.

Growing a Company

The business model continued to change. Troy planned to market and capture orders and put orders up for bid and to use the Google AdWords model. This turned out to be too cumbersome. Every week or two, the website expanded. Part numbers increased from a few hundred to a few thousand in a short time.

Just as Troy's business model had changed over time, his organization plan evolved as the company grew. He had originally planned to use all part-time people and furnish them with procedures manuals to standardize the process. Each employee would have a laptop. This turned out not to be feasible in the long run.

Shortly after the company's launch, Ryan Stubblefield graduated from Louisiana Tech and moved to Tennessee to attend graduate school. He managed the "back end" of the company for his father while he worked on his MBA. He graduated in December 2003 and had to decide whether to move home to Bossier City or to go somewhere else. Still single and not sure that he wanted to live in his old hometown indefinitely, Ryan moved back to Bossier in spite of his reservations. He lived off savings for a while and worked for his father's company without a salary.

Vicki Stubblefield, Troy's wife and Ryan's mother, operated a home-based travel agency from 1997 to 2003. The agency had done well at first, but competition from Cheaptickets.com and other online services had eroded her market to a point where the business was no longer viable. During her last year in business, she only handled travel arrangements for groups. Vicki began helping out with the ToolTopia venture at that point. She remembers loading JPEG pictures into the ToolTopia site while Ryan was away in Tennessee. In 2003, her interest in missionary work led her to enroll in classes at New Orleans Baptist Theological Seminary's extension campus in Shreveport. While there, she became friends with another student named Rebecca Council who would later join the Stubblefields on the ToolTopia venture.

After returning to Shreveport to work with his father, Ryan worked with a general manager on the ToolTopia project full-time. Troy's secretary processed ads and checked on the site. The general manager was released in fall of 2004. At some point, Vicki began to help with accounting, and the Stubblefields hired Rebecca Council, Vicki's classmate at the seminary, to serve as the company's first customer service representative. Ryan and Rebecca worked every day and Vicki dropped in from time to time to assist as needed. Vicki remembered helping with invoices. She was generously compensated with bi-weekly free lunches. Ryan contacted a local temp service and used temporary employees to handle the rest of the work. If they found a temporary employee they liked well enough to keep, they would hire him or her directly. It was in 2004 that Amazon contacted ToolTopia. Amazon was just starting to use third-party seller partnerships, and they wanted to put ToolTopia in tools and hardware. The Stubblefields agreed, and their company's partnership with Amazon brought a major boost to their sales volume.

Troy realized, around that time, that ToolTopia needed full-time employees in pre-sale and post-sale administrative positions. Two employees, Travis and Sarah Anne, joined the group at that point. Travis took care of pre-sale responsibilities, gathering quotes and specs and answering questions, and Sarah Anne provided post-sale service. A network of part-time employees assisted her. If an order had not arrived, if there was an error in an order, or if the box or product was damaged in some way, the post-sale service staff dealt with it. Ryan was in charge of all of the employees, and Troy (who still loved dealing directly with customers) sometimes called customers who had problems and worked out solutions for them. Ryan, Travis, and Sarah Anne all worked in a corner office at Shreveport Air Tools. There were four desks crammed into a single room, and ToolTopia employees often stepped outside for privacy when they received phone calls.

Troy talked about some of the differences in the mindsets and skills of his employees at Shreveport Air Tools and those at ToolTopia. Shreveport Air Tools, he said, was a traditional brick-and-mortar business. Skilled blue-collar employees in coveralls and work clothes rebuilt industrial equipment in a workshop environment. ToolTopia had a younger workforce made up of college students and recent college graduates. People in that demographic, he said, wanted coffee bars and ice cream machines. They believed in working hard and then shooting baskets. They also expected to have more of a say in the overall direction of the company. Since the technology side of the online

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business had moved beyond Troy's own expertise, he said, he had to rely on them to handle the technical aspects of the company. To keep up with that side of the business, Troy met with Ryan every day for lunch to discuss what was going on.

Though the ToolTopia staff dealt with existing suppliers on a day-to-day basis, Troy remained active in the process of negotiating the more crucial arrangements. Ryan traveled with Troy to meet with suppliers, but only observed at first. They would discuss the meetings on the flight home. During the six years ToolTopia was in business, Troy trusted Ryan with more and more of the negotiating and eventually allowed him to handle most of it while he observed.

Changing Facilities

In 2006, ToolTopia moved from its original corner office location to the second floor of an office building owned by Troy's son-in-law, Jeff Luce, who was married to Ryan's older sister. They were located in a single large room that was twice the size of the room at Shreveport Air Tools. They stayed there for a year. Other than Vicki herself, as Vicki recalls, all of the employees were around 26 years old. They had a joke that only 26-year-olds could work there. Vicki was the "mom" of the group, and they liked to tease her. She endured it good-naturedly and remembers that time fondly. She specifically remembers, for example, a day when the group walked down to Shreveport's Red River Revel for lunch and how they put up a Christmas tree in December. Vicki kept switching the radio to a station that was playing Christmas songs, and the other employees switched it back to other stations. Overall, she says, it was a good time. With so many young adults in one place, the atmosphere was always filled with energy

After spending a year in the second-floor office, ToolTopia moved to a suite of offices on Industrial Drive. There were three individual offices and a common area. Vicki started working from home when they made the move. Ryan and the others gutted, painted, and took out a wall to fit the Industrial Drive office to their needs. Vicki said she didn't want to have to paint her own office so she just moved home. Her old travel agency had been home-based, so working from home was nothing new to her. She communicated with Ryan about invoices through the monitors in her office. Ryan insisted that the office would be paperless. They did not even have phone books. That made it easier to move documents from one location to another. The invoices were uploaded by 3 a.m. On the typical day, Vicki saw around 100 of them. During the Christmas season, the number increased to between 400 and 600 invoices.

Shifting to a Virtual Workspace

In 2007, Ryan found himself "getting antsy" in Shreveport-Bossier. He had moved home after earning his MBA but had not planned to settle there permanently. He found himself looking at Dallas, Baton Rouge, and Nashville. "I want to move," he thought. "How can I move?" In fall, 2007, he made the decision to move to Dallas and to transform ToolTopia into a virtual workspace organization within 90 days. He announced his decision to his two highest-paid employees, Travis and Sarah Anne. Their reaction was mixed. "I could never work from home," Travis told him. "Could I go back to Shreveport Air Tools?" Sarah Anne was excited. She helped Ryan coordinate the process.

Shifting ToolTopia's operations from an office-based environment to a telework system required both technological and operational adjustments. They had to break down the system and decide which software ran from a server and which ran from the Internet. They had to figure out how to get their own server onto a Virtual Private Network (VPN) and moved the server to Troy and Vicki's home. As complicated as this process sounds, they managed to complete it in 30 days. They also had to develop a virtual phone system. To do this, they had to find a company that would take an 800 number and route calls in a certain order.

The entire process of shifting to a virtual workspace arrangement was completed ahead of schedule. Vicki had already moved home, and Rebecca and the three or four part-time college students who worked for the company moved home one by one. Travis moved back to the corner office at Shreveport Air Tools, Sarah Anne moved home, and Ryan moved to Dallas.

Within a few months of the transition, depression began to set in. Ryan worked alone from an apartment in Dallas for eight hours a day. Vicki noticed that the employees she talked to weren't doing too well emotionally either. Most of them had gained weight and reported feeling sluggish. Their offices were messy with Oreos, cigarette butts, and other clutter lying around. Many of them didn't bother to get dressed for work. Ryan said his immune system didn't work as well when he worked at home.

When Vicki Stubblefield saw the difference in Ryan and the other employees, she set about coming up with a solution. Noticing the parallels between home-based teleworkers and stay-at-home parents, Vicki drew on the resources of self-help "Fly Lady" Marla Cilley who gave viewers advice on staying motivated and dealing with clutter.

As Ryan expressed it, life went on. Some of the company's employees thrived in a virtual workspace setting, and some found it harder to deal with. None of the full-time employees left, but they had to make lifestyle adjustments to cope. Ryan started taking his laptop to a coffee shop and working from there. Within two years of the company's shift to a telework-based model, the company's part-time workforce went from being made up mainly of college students to being mostly stay-at-home mothers and empty nesters. There was never a deliberate choice to "get rid of the kids," of course, but Vicki and Ryan's married older sister, Tonya, had less direct contact with college students and more with other women whose situations were similar to their own.

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A Chance to Sell the Business

ToolTopia had been in business for six years when their largest supplier offered to buy the business. Ryan and Troy had flown to Florida to meet with them as they had many times before, and it was during a round of golf on one of Florida's sunny golf courses that the offer was made. They discussed the offer as they flew back to Louisiana.

Ryan thought selling the business was a good idea. The company did not really have any hard assets, patents, or proprietary software. What they had was a client base and a history of sales. Certain changes in the market were threatening to take the "glow" off the business. When ToolTopia launched in 2002, there were no laws or mechanisms in place to collect sales tax on Internet sales, but that was changing. The company was being contacted more and more about sales tax issues, and the virtual nature of the company made it difficult to really say which state a transaction had taken place in. Had the transaction taken place in the customer's apartment, at the customer's place of business, or at the place from which the product had been shipped? Another complication was the decline in the interest rates of money market and SWEEP accounts. There was also more competition than there had been initially.

One aspect of the company's offer that Ryan was not entirely comfortable with was that the would-be buyer wanted the Stubblefields to sign a confidentiality agreement. None of their customers or even the non-family employees of ToolTopia would be told that the company had been sold. The supplier would pay a fee to use Troy's face on the website as the company's founder, but Troy would no longer be involved in the day-to-day operation of the firm. Keeping the sale of the company secret from so many people could prove to be difficult. What should they do?

Questions

1. How has the public perception of online retailing changed since ToolTopia first started in business in 2002? Explain.
2. What technical and personnel hurdles did Ryan Stubblefield face when he decided to turn the company into a virtual workspace? If you were an employee, how would you have responded to Ryan's announcement?
3. Compare and contrast ToolTopia's virtual workspace with the concept of a virtual network structure.
4. How, according to Troy, was managing millennial generation workers different from managing his traditional workforce?

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INTEGRATIVE CASE 12.0

Sometimes a Simple Change Isn't So Simple*

Introduction

On Monday, Kate Cohen was excited because the day for implementing the new computerized medical administration record had finally arrived. The medication administration record (MAR) was a chart of all of the medications administered to a patient by the hospital staff at Central Hospital. Kate, a programmer/analyst in the Management Information Systems department, led a team to computerize the MAR. The team had been working diligently on the pilot project for a year and hoped for a smooth execution. The computerized MAR was launched and immediately failed. By 10:00 A.M., floor nurses and staff pharmacists complained that the system did not work and was too complicated. After hearing nurses' complaints, physicians expressed concern about patient safety. At 1:30 P.M., the computer system crashed, and the MAR project was suspended. Late in the afternoon, Kate assembled the project team to study the project failure.

On Tuesday, Kate Cohen arrived at work early feeling very worried and anxious. At 2:00 P.M., Kate would be making a presentation to Central Hospital's management group on the MAR project failure. As Kate began to prepare for the meeting, she thought back over the evolution of the MAR project.

Background

Central Hospital was a community hospital affiliated with Integrated Health, a large, private, nonprofit healthcare system in Tempe, Arizona. Integrated Health consisted of four community hospitals located within a 75-mile radius, three long-term care facilities, a heart institute, a cancer treatment center, two graduated care retirement facilities, a hospital services company, and a health maintenance organization. Integrated's Board of Directors decided to implement the MAR in stages. In the first stage, the MAR system would be developed and implemented at Central Hospital. After the problems were worked out, the MAR would be implemented throughout other facilities of Integrated Health. Responsibility for the MAR project was delegated to the MIS department at Central, and today it seemed to rest squarely on Kate's shoulders.

The Rationale

Regulatory and competitive changes in the healthcare industry resulted in a more complex and dynamic environment. According to the National Coalition on Healthcare, the United States spent $1.9 trillion on healthcare per year, of which $450 billion were administrative costs. At Integrated Health, administrative costs rose at an annual rate of six percent, and the board's strategy to reduce administrative costs began with the MAR.

As the trend in insurance coverage shifted from indemnity plans to managed care and capitation, insurers required that healthcare providers document services in a timely, accurate manner. Paper charts or records were the traditional method of reporting information. The need to deliver more information in shorter time periods resulted in paper reporting not being an efficient or effective method of delivering this data to insurers. For use within the healthcare system, paper charts must be physically transferred from one department to another as patients move from department to department. In the industry, specialists reported that patients referred to them ended up without a paper file 30 percent of the time. Moreover, it was reported that lost paperwork or illegible handwriting resulted in 10 to 15 percent of patients' medical tests being repeated unnecessarily.

Integrated's management learned that private insurance companies, Medicare and Medicaid would soon require electronic transfer of patient information on treatment, medication, surgical procedure reports, and billing information. This information would be collected in a centralized database and then uploaded to the computers of the insurers. Computerized records were retrievable by those who need access to patient information in order to provide services or to process requests for payment. Electronic transfer of all information was expected to become a requirement in the future. One aspect of patient information that lends itself to computerization from both clinical and data collection perspectives was medication charting.

Like most other healthcare systems, Integrated was trying to adjust and position itself for the changes and challenges that managed healthcare would bring. Integrated's management viewed the move to a system such as MAR as one of many business process changes necessary if the system was going to be competitive in the long term. For example, if the MAR project was successful, most billing functions could be completed on the day of service. Therefore, the hospital

* Edward Jernigan, University of North Carolina at Charlotte; Joyce M. Beggs, University of North Carolina at Charlotte, "Sometimes a Simple Change Isn't So Simple," *Journal of the International Academy for Case Studies* 17, no. 3 (2011), 41–48.

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could receive payment more quickly with the utilization of fewer resources. Ultimately, the MAR could eliminate the need for most of the manual billing and allow for staff reductions.

For years, Integrated Health had invested little money in information technology. Instead of utilizing the power of technology, the company had relied on old-fashioned paper records held in rows of filing cabinets. Central's computer system was still primarily a mainframe system that some staff considered antiquated, and hardware limitations resulted in cumbersome applications for several clinical departments.

The Project Team

Art Baxter, the chief information officer at Central Hospital, decided to computerize the MAR over a one-year period. Art heard rumors of a management shakeup at Central Hospital but thought MIS would not be affected. Completing the MAR in such a short period of time would definitely improve Art's image. Art, a former plumbing supply salesperson, lacked a technical background in MIS and was known to boast about not knowing how to turn on a computer. Art's cousin was a member of Central's Board of Directors.

Art assigned Kate Cohen as project leader of the MAR. Kate was known as one of the better programmer/analysts at Central, and she was given day-to-day operational responsibility for the MAR project. Art told Kate that except for monthly executive updates and critical decisions he would not be involved with the project.

Kate assembled a project management team consisting of Guy Smith, pharmacy operations coordinator and MIS liaison; Lauren Hill, nurse trainer and MIS liaison; and Ben Hoffman from Internal Audit. Kate developed good working relationships with Guy and Lauren, who represented two departments critical to the success of this project. Guy Smith had experience developing and implementing the computerized order entry system used in Pharmacy Services for four years. Guy personally developed most of the user applications for the order entry system. Kate felt he would be an asset in developing MAR user applications. Lauren Hill was often referred to as "Super Trainer" because of her ability to train even the most difficult employee. Ben Hoffman was an expert on accounting information systems; he had been at Central Hospital for a short time, and the computerized MAR was his first major project. Additional representatives from MIS, Nursing Services, Pharmacy, Internal Audit, Accounting, and other areas of the hospital served on the team on an as needed basis.

For Kate Cohen and other MIS employees, the MAR project was a chance to create a good impression. Therefore, the attitude of the MIS staff was generally positive. If the MAR was successfully developed and implemented at Central, Kate might be asked to lead the MAR project across Integrated Health. The MIS staff viewed the MAR project as an opportunity to demonstrate their importance to Integrated Health. With the pressure on healthcare providers to hold down costs, the MIS staff thought that the project was a chance to prove their value to the organization and protect them from a layoff.

MAR Project Development

When the MAR implementation target date was 12 months away, the team assembled and developed an action plan. Software preparation began in earnest; and after about three months, Kate and Guy finished the coding work on roughly one-third of the user screens. In the fourth month, several demonstrations of the software and available reports were offered to physicians. However, physician turnout to the demonstrations was poor. At first, Kate thought low turnout indicated a low level of interest. Later Kate concluded that the low turnout was not necessarily a bad sign for the team, given physicians' busy schedules.

The team members worked well with each other. In the early stages of the project, the team met at least twice every month to review progress and make new assignments. Communication flowed freely between the team and two of the ultimate end users—the pharmacy and the billing department. However, not much information seemed to pass between the team and other end users of the MAR such as nursing.

Jane Ritchie, the director of nursing, did not support the change to the MAR system. Jane was more comfortable with doing work the traditional way, and she rarely accepted change without noticeable resistance. Jane felt that the nurses had only limited information about the MAR project and that the benefits of the MAR were unclear. Furthermore, an undercurrent of antagonism surfaced between Jane and Art because of the nurses' frustration over the MAR project.

The nursing staff at Central was considered critical to the success of the MAR project. Nurses would be responsible for entering over 50 percent of the data, and the MAR project would create a significant addition to their heavy workload. Occasionally, during development, the nurses were asked for their input. Approximately half of their suggestions and requests could not be accommodated due to coding issues or to limits on computer capability. Generally, the nurses felt their suggestions and recommendations were rejected without full explanation. Members of the nursing staff and MIS met several times to assess whether or not implementing the computerized MAR in 12 months was achievable.

The pharmacists saw the MAR as the logical extension of the computerized order entry function that they had been using for four years. In the entry function, the pharmacist reads the physician's order for a specific patient and enters it into the computer. Pharmacists anticipated some initial problems but knew from experience that most issues

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could be solved. Pharmacists equated the MAR development and implementation process to growing pains, while nurses saw it as unnecessary. To the pharmacists, the computerized MAR was a tool to reduce work, errors, and time spent entering orders. This time could be better spent on more rewarding clinical and professional activities. In general, pharmacists saw computerization as the only option, and most were used to change. The profession had evolved from compounding and dispensing drugs to patient education, drug information services, and pharmacokinetics consultations. New drugs emerged weekly, especially biotech and genetically engineered drugs, so change was expected.

Guy Smith, who developed the pharmacy subsystem, was asked about the feasibility of the implementation date. After reviewing the screens and hearing the concerns of the nurses, Guy thought that the target date was too ambitious. Lauren Hill, the nurse trainer, thought that the nurses would not be ready to use the system in 12 months. She just did not see how she could train Central's 400-member nursing staff in the time available. Kate Cohen thought the screen modifications and programming changes requested by the nurses could take between nine and 12 months. However, Art Baxter rejected the advice of Guy, Lauren, and Kate and refused to change the implementation date.

Testing

Kate and Guy tested the MAR at every phase of development. During testing, only a few users were on the system at one time. As many scenarios as possible were tried during each test. However, because of the large number of possible combinations, everything did not come up for review. Corrections were made as soon as glitches were identified. As a follow-up, Ben Hoffman, the internal auditor, conducted a test of the full system a month before the scheduled implementation date.

Training

User training for nurses began about three months before the target implementation date for the MAR. Lauren Hill, the nurse trainer, was responsible for teaching 400 nurses everything they needed to know about online MAR charting. She thought the training had gone well and had patterned the nurses' training after the training for the pharmacy department's computerized entry function. The training plan included a pre-test, an online demonstration, and a post-test. In order to accommodate all the nurses in such a short timeframe, the class sizes were large. The class size for the pharmacists had been small since there were only 20 pharmacists.

During the training, the nurses complained that the screens were too cluttered, and they became more and more frustrated with the user-unfriendly screens. Another frequent complaint expressed by nurses was that the screens were difficult to read. There was nothing on the screens that stood out to direct the eye to a specific function. In order to complete a transaction, multiple screens were required, and frequently the system response time to move from one screen to another seemed too slow. There were times when the information from the nursing subsystem did not synchronize with the pharmacy subsystem. Another frequently voiced concern was the lack of available computer terminals on which to enter the data and the distances from the patient's room.

Reorganization

About four months after Kate and her team had begun work on the MAR project, reorganization at Central Hospital was announced (See Exhibit 1 and Exhibit 2). Greg Korensky, vice president of operations, was moved into a newly created position of executive vice president. Greg would have responsibility for coordinating operations across the Integrated Health system rather than just at Central Hospital. In another important change, Food and Nutrition and Pharmacy Services would become part of the Nursing division. The jobs of the chief operating officer, the director of nursing, and the hospital operations administrator were eliminated as part of the restructuring. The positions held by the director of nursing and the hospital operations administrator were combined into a single position of vice president of patient care services.

After a six-month search, Sharon Green joined Central Hospital as the vice president of patient care services. She quickly became an enthusiastic supporter of the MAR project. However, Sharon was out of town on the day the MAR was implemented, due to being on vacation.

Implementation

On Monday, the MAR was implemented and immediately failed. Floor nurses and staff pharmacists complained that the MAR was too complicated, then physicians expressed concern about patient safety, and next the computer system crashed. Therefore, the MAR project was suspended, and Kate's team assembled late yesterday afternoon to review the failure. On Tuesday, at 2:00 P.M., Kate would present to the hospital's management. Kate wondered what she was going to say.

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EXHIBIT 1

Partial Organization Chart for Central Hospital before the Reorganization

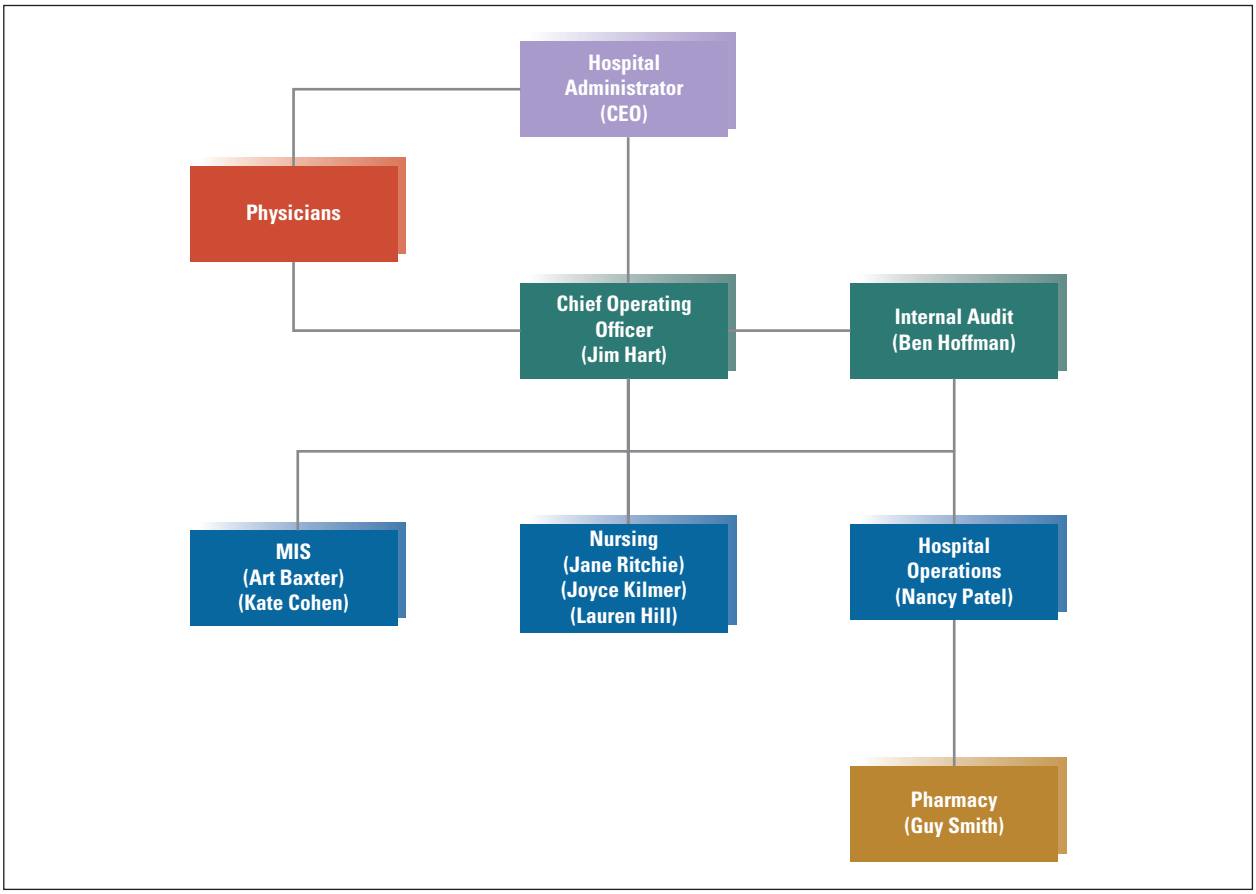
Hospital Administrator (CEO)
Physicians
Chief Operating Officer (Jim Hart)
Internal Audit (Ben Hoffman)
MIS (Art Baxter) (Kate Cohen)
Nursing (Jane Ritchie) (Joyce Kilmer) (Lauren Hill)
Hospital Operations (Nancy Patel)
Pharmacy (Guy Smith)

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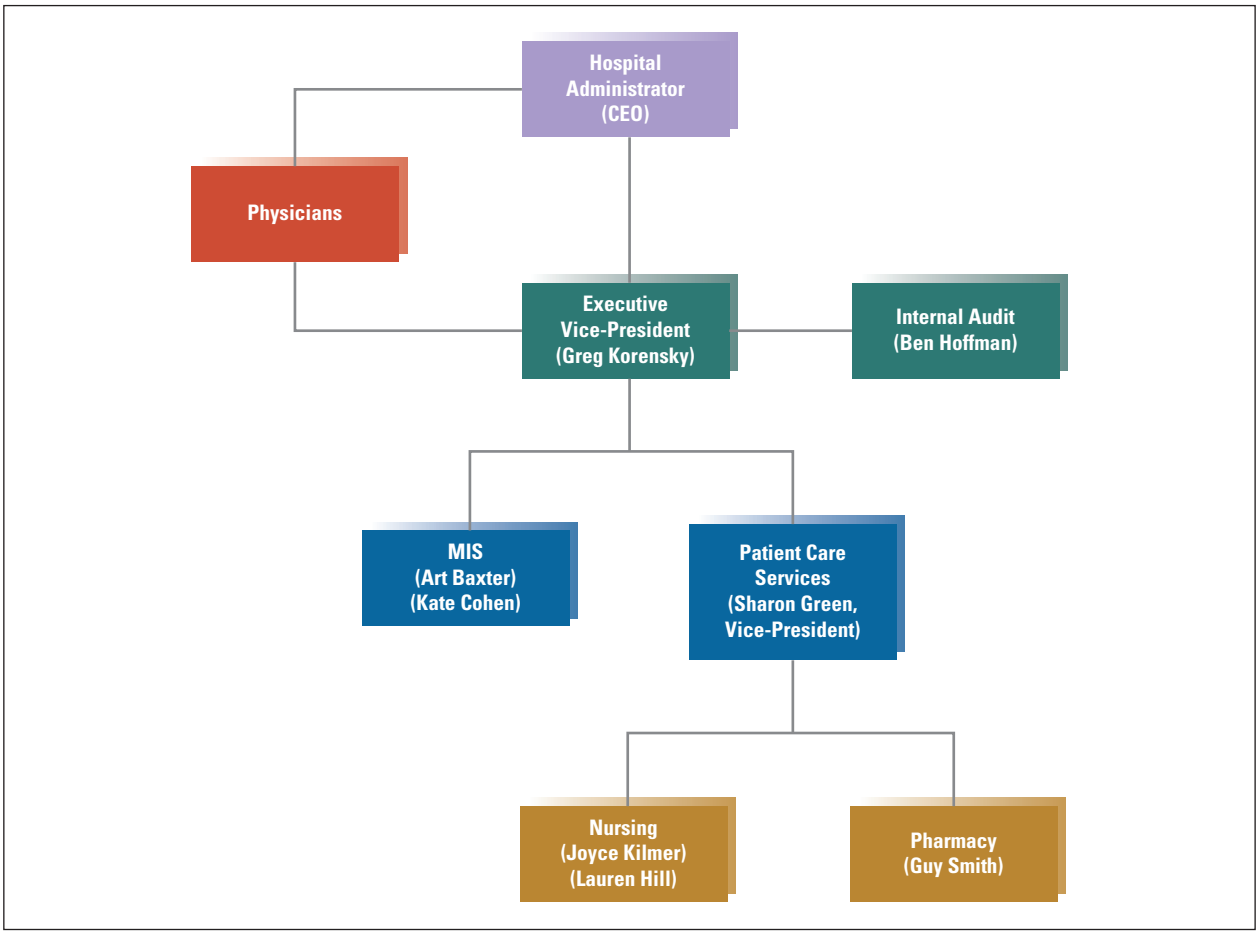
EXHIBIT 2

Partial Organization Chart for Central Hospital after the Reorganization



Questions

1. What caused the implementation of MAR to fail?
2. Why do you think the nurses resisted the MAR project?
3. What techniques should managers use to overcome the resistance to change?
4. What impact do you think the changes in organization structure and responsibilities had on the implementation of MAR? Why?

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Glossary

A

achievement culture a culture characterized by emphasis on a clear vision of the organization's purpose and on the achievement of goals, such as sales growth, profitability, or market share, to help achieve the purpose.

adaptability culture a culture characterized by strategic focus on the external environment through flexibility and change to meet customer needs.

administrative principles a management perspective that focuses on the design and functioning of the organization as a whole.

algorithm a set of systematic rules built into software to make decisions and accomplish desired outcomes in many areas.

algorithmic control the use of software algorithms to set targets, measure performance, provide feedback, and decide rewards for employees.

ambidextrous approach a design approach that incorporates structures and management processes that are appropriate for both the creation and the implementation of innovation.

analyzability a dimension of technology in which work can be reduced to mechanical steps and participants can follow an objective, computational procedure to solve problems.

analyzer a strategy that tries to maintain a stable business while innovating on the periphery.

artificial intelligence encompasses techniques used to teach computer systems to learn, reason, perceive, infer, communicate, and make decisions similar to or better than humans.

authority a force for achieving desired outcomes that is prescribed by the formal hierarchy and reporting relationships.

B

balanced scorecard a comprehensive management control system that balances traditional financial measures with operational measures relating to a company's critical success factors.

behavior control managers' direct observation and supervision of employee actions to see whether the individual follows rules and policies and performs tasks as instructed.

benefit corporation a for-profit entity that specifies positive social and environmental impact as well as profit in its legally chartered goals.

big data refers to any massive data set that exceeds the boundaries and conventional processing capabilities of traditional IT.

big data analytics refers to the process of examining these large data sets to uncover hidden patterns, correlations, and other useful information and make better decisions.

bottom of the pyramid (**BOP**) a concept proposing that large multinational corporations can alleviate poverty and other social ills, as well as make significant profits, by selling to the world's poorest people.

boundary-spanning roles activities that link and coordinate an organization with key elements in the external environment.

bounded rationality perspective a perspective that describes how decisions actually have to be made under severe time and resource constraints.

buffering roles activities that absorb uncertainty from the environment.

bureaucracy an organizational framework marked by rules and procedures, specialization and division of labor, hierarchy of authority, emphasis on technically qualified personnel, and written communications and records.

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bureaucratic control the use of rules, policies, hierarchy of authority, written documentation, standardization, and other bureaucratic mechanisms to standardize behavior and assess performance.

bureaucratic culture a culture with an internal focus and a consistency orientation for a stable environment.

bureaucratic organizations organizations that emphasize designing and managing on an impersonal, rational basis through such elements as clearly defined authority and responsibility, formal recordkeeping, and uniform application of standard rules.

business intelligence high-tech analysis of large amounts of internal and external data to spot patterns and relationships that might be significant.

C

Carnegie model organizational decision making that involves many managers making a final choice based on a coalition among those managers.

centrality reflects a department's role in the primary activity of an organization and is a source of horizontal power.

centralization refers to the level of hierarchy with authority to make decisions.

change process the way in which changes occur in an organization.

charismatic authority authority based on devotion to the exemplary character or to the heroism of an individual person and the order defined by him or her.

clan control the use of social characteristics, such as shared cultural values, commitment, traditions, and beliefs, to control behavior.

clan culture a culture with a primary focus on the involvement and participation of the organization's members and on rapidly changing expectations from the external environment.

coalition an alliance among several managers who agree about organizational goals and problem priorities.

code of ethics a formal statement of the organization's values concerning ethics and social responsibility.

codified knowledge formal, systematic knowledge that can be articulated, written down, and passed on to others in documents, rules, or general instructions.

coercive forces the external pressures exerted on an organization to adopt structures, techniques, or behaviors similar to other organizations.

cognitive biases severe errors in judgment that all humans are prone to and that typically lead to bad choices.

collaboration a joint effort between people from two or more departments to produce outcomes that meet a common goal or shared purpose and that are typically greater than what any of the individuals or departments could achieve working alone.

collaborative-network perspective an emerging perspective whereby organizations join together to become more competitive and to share scarce resources.

collective bargaining the negotiation used to resolve disagreement between workers and management.

collectivity stage the life cycle stage in which employees identify with the mission of the organization and spend long hours helping the organization succeed. Members feel part of a collective.

competing values model a model that tries to balance a concern with various parts of the organization rather than focusing on one part.

competition rivalry among groups in the pursuit of a common prize.

competitive advantage refers to what sets the organization apart from others and provides it with a distinctive edge for meeting customer or client needs in the marketplace.

complexity refers to heterogeneity, or the number and dissimilarity of external elements that affect an organization's operations.

compliance officer a high-level company executive who oversees all aspects of ethics, including establishing and broadly communicating ethical standards and advising managers on the ethical aspects of corporate decisions.

confrontation a situation in which parties in conflict directly engage one another and try to work out their differences.

conscious capitalism refers to organizational policies and practices that both enhance the economic success of a company and advance the economic and social conditions of the communities in which the company operates; also referred to as a shared value approach.

contingency a theory meaning that one thing depends on other things; the organization's situation dictates the correct design and management approach.

contingency decision-making framework a perspective that brings together the two dimensions of problem consensus and technical knowledge about solutions.

contingency factors larger elements that influence structural dimensions, including the organization's size, technology, environment, culture, and goals.

continuous process production a completely mechanized manufacturing process in which there is no starting or stopping.

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cooptation occurs when leaders from important sectors in the environment are made part of an organization.
core competence something the organization does especially well in comparison to its competitors.
core technology the work process that is directly related to the organization's mission.
corporate social responsibility (**CSR**) refers to management's obligation to make choices and take action so that the organization contributes to the welfare and interest of all organizational stakeholders.
craft technologies are characterized by a fairly stable stream of activities, but the conversion process is not analyzable or well understood.
creative departments departments that initiate change, such as research and development, engineering, design, and systems analysis.
creativity the generation of novel ideas that may meet perceived needs or respond to opportunities.
cross-functional teams permanent task forces made up of members from different functional areas and often used in conjunction with a full-time integrator.
crowdsourcing an approach to open innovation that solicits ideas, services, or information from a large number of volunteers, usually via social media and the Internet.
cultural intelligence the ability to use reasoning and observation skills to interpret unfamiliar gestures and situations and devise appropriate behavioral responses.
culture the set of values, norms, guiding beliefs, and understandings that is shared by members of an organization and taught to new members as the correct way to think, feel, and behave.
culture innovations changes in the values, attitudes, expectations, beliefs, abilities, and behavior of employees.
culture strength the degree of agreement among members of an organization about the importance of specific values.

D

data intermediaries firms that collect data from multiple organizations and analyze the combined data for outsourcing partners.
data warehousing the use of huge databases that combine all of a company's data and allow users to access the data directly, create reports, and obtain responses to what-if questions.
decentralization means that decision-making authority is pushed down to lower organizational levels.
decentralized control uses rules and procedures only when necessary and relies on shared goals and values to guide behavior.
decision learning a process of recognizing and admitting mistakes that allows managers to acquire sufficient experience and knowledge to perform more effectively in the future.
defender a business strategy that is concerned with stability or even retrenchment.
departmental grouping a grouping in which employees share a common supervisor and common resources, are jointly responsible for performance, and tend to identify and collaborate with one another.
dependency an aspect of horizontal power, in which one department is dependent on another and the latter is in a position of greater power.
devil's advocate the role of challenging the assumptions and assertions made by the group.
differentiation the differences in cognitive and emotional orientations among managers in various functional departments and the differences in formal structure among these departments.
differentiation strategy a business strategy that attempts to distinguish an organization's products or services from others in the industry.
direct interlock occurs when one individual is the link between two companies, such as when a member of one company's board also sits on the board of another company.
disruptive innovation refers to innovations that typically start small and end up completely replacing an existing product or service technology for producers and consumers.
divisional grouping a grouping in which employees are organized according to what the organization produces.
divisional structure a structure in which separate divisions can be organized with responsibility for individual products, services, product groups, major projects or programs, divisions, businesses, or profit centers; sometimes called a *product structure* or *strategic business units*.
domain the chosen environmental field of action; the territory an organization stakes out for itself with respect to products, services, and markets served.
domains of political activity areas in which politics plays a role. Three domains in organizations are structural change, management succession, and resource allocation.
domestic stage the first stage of international development in which a company is domestically oriented while managers are aware of the global environment and may want to consider initial foreign involvement to expand production volume and realize economies of scale.

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dual-core approach an organizational change perspective that compares management and technical innovation.
dynamism refers to whether the environment in which the organization operates is stable or unstable.

E

economies of scale achieving lower costs through large volume production; often made possible by global expansion.
economies of scope achieving economies by having a number and variety of products and services or by operating in a number and variety of regions, countries, and markets.
effectiveness the degree to which an organization achieves its goals.
efficiency the amount of resources used to achieve an organization's goals; based on the quantity of raw materials, money, and employees necessary to produce a given level of output.
elaboration stage a mature stage of the life cycle in which a red tape crisis is resolved through the development of a new sense of teamwork and collaboration.
empowerment the delegation of power or authority to subordinates in an organization, also known as *power sharing*.
engineering technologies tend to be complex because there is substantial variety in the tasks performed, but the various activities are usually handled on the basis of established formulas, procedures, and techniques.
entrepreneurial stage the life cycle stage in which an organization is born and its emphasis is on creating a product and surviving in the marketplace.
escalating commitment continuing to invest time and money in a solution despite strong evidence that it is not working.
ethical dilemma arises in a situation concerning right and wrong in which each alternative choice seems undesirable because of potentially negative ethical consequences.
ethics the code of moral principles and values that governs the behaviors of a person or group with respect to what is right or wrong.
ethics committee a cross-functional group of executives who oversee company ethics.
ethics hotlines telephone numbers employees can call to seek guidance as well as report questionable behavior.
evidence-based management a commitment to make more informed and intelligent decisions based on the best available facts and evidence.
exchange platforms platform-based organizations that facilitate 1:1 interactions among members, such as Uber or Lyft.
expert-locator system systems that identify and catalog experts in a searchable database so people can quickly identify who has knowledge they can use.
external adaptation refers to how the organization meets goals and deals with outsiders.

F

factors of production resources necessary for production, such as land, raw materials, and labor.
feedback control model a control cycle that involves setting strategic goals for departments or the organization as a whole, establishing metrics and standards of performance, comparing metrics of actual performance to standards, and correcting or changing activities as needed.
focus a value dimension that states whether dominant values concern issues that are *internal* or *external* to the firm.
formalization the degree to which an organization has rules, procedures, and written documentation.
formalization stage the life cycle stage that involves the installation and use of rules, procedures, and control systems.
functional grouping a grouping that places together employees who perform similar functions or work processes or who bring similar knowledge and skills to bear.
functional matrix type of matrix structure in which the functional bosses have primary authority and the project or product managers simply coordinate product activities.
functional structure organization structure in which activities are grouped together by common function from the bottom to the top of the organization.

G

garbage can model decision-making model that describes the pattern or flow of multiple decisions within an organization.
general environment those sectors that might not have a direct impact on the daily operations of a firm but will indirectly influence it.
generalist an organization with a wide niche or domain that offers a broad range of products or services or serves a broad market.
global companies companies that no longer think of themselves as having a single home country; sometimes called *stateless corporations*.

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global geographic structure structure that divides the world into geographic regions, with each geographic division reporting to the CEO.

global matrix structure a form of horizontal linkage for an international organization in which both product and geographical structures are implemented simultaneously.

global product structure structure in which the product divisions take responsibility for global operations in their specific product area.

global stage the stage of international development in which the company transcends any single country.

global teams cross-border work groups made up of multinational members whose activities span multiple countries; also called *transnational teams*.

globalization strategy the standardization of product design, manufacturing, and marketing strategy throughout the world.

glocalization strategy a strategy that seeks to achieve both global integration and local responsiveness.

goal approach an approach to effectiveness that is concerned with an organization's output goals and assessing how well the organization has attained those goals.

groupthink the tendency of people in groups to suppress contrary opinions.

H

Hawthorne Studies a series of experiments on worker productivity begun in 1924 at the Hawthorne plant of Western Electric Company in Illinois; attributed employees' increased output to managers' better treatment of them during the study.

heroes organization members who serve as models or ideals for upholding cultural norms and values.

hierarchical control involves monitoring and influencing employee behavior through extensive use of rules, policies, and hierarchy of authority, written documentation, reward systems, and other formal mechanisms.

high reliability organization (HRO) an organization that has developed techniques to manage highly complex and potentially hazardous technologies in a safe and reliable manner.

high-performance culture a culture that emphasizes both positive, adaptive cultural values and solid business results.

high-velocity environments industries in which competitive and technological change is so extreme that market data is either unavailable or obsolete, strategic windows open and shut quickly, and decisions must be made quickly with limited information.

holacracy team grouping a recent approach to structural grouping in which the entire organization is made up of self-managing teams that include the people needed to accomplish a specific task or activity.

holacracy team structure an extreme self-management model in which circles (teams) are the basic unit and building block of structure and each circle shares a common purpose and has decision-making authority over how to do its work and achieve its purpose.

horizontal coordination model a model of the three components of organization design needed to achieve new product innovation: departmental specialization, boundary spanning, and horizontal coordination.

horizontal linkage refers to communication and coordination horizontally across organizational departments.

human relations emphasis incorporates the values of an internal focus and a flexible structure.

hybrid organization an organization that mixes value systems and behaviors that represent two different sectors of society, which leads to tensions and conflict within the organization over goals and priorities.

I

idea champions organization members who provide the time and energy to make change happen; sometimes called *advocates*, *intrapreneurs*, or *change agents*.

idea incubator a safe harbor in which ideas from employees throughout the organization can be developed without interference from company bureaucracy or politics.

imitation the act of adopting a decision tried elsewhere in the hope that it will work in this situation.

incremental decision model decision-making model that describes the structured sequence of activities undertaken from the discovery of a problem to its solution.

indirect interlock occurs when a director of company A and a director of company B are both directors of company C.

inspiration refers to an innovative, creative solution that is not reached by logical means.

institutional environment norms, values, and expectations from stakeholders (e.g., customers, investors, boards, government, and the community).

internal business intelligence refers to the high-tech analysis of a company's data in order to make better strategic decisions.

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institutional perspective the view of how organizations survive and succeed through congruence between an organization and the expectations from its institutional environment.

institutional similarity the emergence of a common structure and approach among organizations in the same field; called *institutional isomorphism* in the academic literature.

integration the quality of collaboration among departments.

integrator a position or department created solely to coordinate several departments.

intellectual capital the sum of an organization's knowledge, experience, understanding, relationships, processes, innovations, and discoveries.

intelligence team cross-functional group of managers and employees, usually led by a competitive intelligence professional, who work together to gain a deep understanding of a specific business issue.

intensive technologies provide a variety of products or services in combination to a client.

interdependence the extent to which departments depend on each other for information, resources, or materials to accomplish their tasks.

intergroup conflict the behavior that occurs among organizational groups when participants identify with one group and perceive that other groups may block their group's goal achievement or expectations.

interlocking directorate formal linkage that occurs when a member of the board of directors of one company sits on the board of directors of another company.

internal integration a state in which members develop a collective identity and know how to work together effectively.

internal process approach in the internal process approach, effectiveness is measured by assessing internal organizational health and efficiency.

internal process emphasis reflects values of internal focus and structural control.

international division a division organized to handle business in other countries.

international stage the second stage of international development, in which the company takes exports seriously and begins to think multidomestically.

interorganizational relationships the relatively enduring resource transactions, flows, and linkages that occur among two or more organizations.

intranet a private, companywide information system that uses the communications protocols and standards of the Internet but is accessible only to people within the company.

intuitive decision making experience and judgment rather than sequential logic or explicit reasoning are used to make decisions.

J

joint venture a new and distinct organizational entity set up by two or more organizations to jointly develop an innovative product or shared technology.

K

knowledge management the efforts to systematically find, organize, and make available a company's intellectual capital and to foster a culture of continuous learning and knowledge sharing.

L

labor-management teams a cooperative approach designed to increase worker participation and provide a cooperative model for union-management problems.

large group intervention an approach that brings together participants from all parts of the organization, often including key stakeholders from outside the organization as well, in an off-site setting to discuss problems or opportunities and plan for change.

large-batch production a manufacturing process characterized by long production runs of standardized parts.

legends stories of historic events that may have been embellished with fictional details.

legitimacy the general perception that an organization's actions are desirable, proper, and appropriate within the environment's system of norms, values, and beliefs.

level of analysis in systems theory, the subsystem on which the primary focus is placed; four levels of analysis normally characterize organizations.

liaison role a role in which a person is located in one department but has the responsibility for communicating and achieving coordination with another department.

life cycle the concept that organizations are born, grow older, and eventually die.

logic a person's basic assumptions, values, and beliefs that he or she thinks should guide an organization's behavior.

long-linked technology the combination in one organization of successive stages of production, with each stage of production using as its inputs the

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production of the preceding stage and producing inputs for the following stage.

low-cost leadership strategy a strategy that tries to increase market share by keeping costs low compared to competitors.

M

maker platforms platform-based organizations that facilitate 1:1,000s interactions among members, such as YouTube or Twitch.

management innovation the adoption and implementation of a management practice, process, structure, strategy, or technique that is new to the organization and is intended to further organizational goals.

management science approach organization decision making that uses mathematical models and statistical techniques to analyze numerous variables and arrive at the best solution; the analog to the rational approach by individual managers.

market control the use of price competition to evaluate the output and productivity of an organization or its major departments and divisions.

mass customization using mass-production technology to quickly and cost-effectively assemble goods that are uniquely designed to fit the demands of individual customers.

matrix structure an organization structure that is multifocused in that both product and function or geography and function are emphasized at the same time.

mechanistic an organization system marked by rules, procedures, a clear hierarchy of authority, and centralized decision making.

mediating technology provides products or services that mediate or link clients from the external environment and allows each department to work independently.

mimetic forces the pressure to copy or model other organizations that are generally regarded as successful.

mission the organization's reason for existence; describes the organization's shared values and beliefs and its reason for being.

mission drift a situation that may arise in a hybrid organization in which people begin to give less importance to their social mission and more importance to generating revenue and profit.

multidomestic means competitive issues in each country are independent of other countries; the company deals with each country individually.

multidomestic strategy strategy in which competition in each country is handled independently of competition in other countries.

multifocused grouping a grouping in which the organization embraces two or more structural grouping alternatives simultaneously, sometimes called *matrix* grouping.

multinational stage the stage of international development in which a company has extensive experience in a number of international markets and has established marketing, manufacturing, or research and development (R&D) facilities in several foreign countries.

N

negotiation the bargaining process that often occurs during confrontation and that enables the parties to systematically reach a solution.

network centrality a source of power based on being centrally located in the organization and having access to information and people that are critical to the company's success.

new-venture fund a fund that provides financial resources for employees to develop new ideas, products, or businesses.

niche a domain of unique environmental resources and needs.

noncore technology a department work process that is important to the organization but is not directly related to its primary mission.

nonprogrammed decisions novel and poorly defined, and no procedure exists for solving a problem.

nonroutine technologies technologies characterized by high task variety, and the conversion process is not analyzable or well understood.

nonsubstitutability a source of horizontal power when a department's function cannot be performed by other readily available resources.

normative forces pressures to achieve standards of professionalism and to adopt techniques that are considered by the professional community to be up to date and effective.

nudge management applies insights from the behavioral sciences to offer gentle reminders, or nudges, toward desired behaviors.

O

official goals formally stated definition of business scope and outcomes the organization is trying to achieve.

open innovation an approach that extends the search for and commercialization of new products beyond the boundaries of the organization.

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open system a system, such as an organization, that must interact with the environment to survive.
open systems emphasis an approach that is shaped by a combination of external focus and flexible structure.
operating goals designate the ends sought through the actual operating procedures of the organization and explain what the organization is trying to do.
organic an organization characterized by free-flowing, adaptive processes, an unclear hierarchy of authority, and decentralized decision making.
organization development focuses on the human and social aspects of the organization as a way to improve the organization's ability to adapt and solve problems.
organization structure designates formal reporting relationships, including the number of levels in the hierarchy and the span of control of managers and supervisors; identifies the grouping together of individuals into departments and of departments into the total organization; and includes the design of systems to ensure effective communication, coordination, and integration of efforts across departments.
organization theory and design a macro examination of organizations analyzing the whole organization as a unit.
organizational behavior a micro approach that focuses on the individuals within organizations as the relevant units of analysis.
organizational change the adoption of a new idea or behavior by an organization.
organizational decision making the process of identifying and solving problems.
organizational decline a condition in which a substantial, absolute decrease in an organization's resource base occurs over time.
organizational ecosystem a system formed by the interaction of a community of organizations and their environment.
organizational environment everything that exists outside the boundary of the organization and has the potential to affect all or part of the organization.
organizational ethics principles that guide the decisions and behaviors of managers regarding whether they are right or wrong.
organizational form an organization's specific technology, structure, products, goals, and personnel, which can be selected or rejected by the environment.
organizational goal a desired state of affairs that the organization attempts to reach.
organizational innovation the adoption of an idea or behavior that is new to the organization's industry, market, or general environment.
organizational politics the activities of acquiring, developing, and using power and other resources to influence others and obtain the preferred outcome when there is uncertainty or disagreement about choices.
organizations social entities that are goal-directed, designed as deliberately structured and coordinated activity systems, and are linked to the external environment.
organized anarchy extremely organic organizations characterized by highly uncertain conditions.
outcome control management control based on monitoring and rewarding results rather than on how those results are obtained.
outsourcing contracting out certain tasks or functions, such as manufacturing or credit processing, to other companies.

P

personnel ratios the proportions of administrative, clerical, and professional support staff.
platform-based organization a form of organization made possible by the Internet and digital technology that connects and enables users to both create and consume something of value.
point–counterpoint a decision-making technique that divides decision makers into two groups and assigns them different, often competing, responsibilities.
political model a definition of an organization as being made up of groups that have separate interests, goals, and values in which power and influence are needed to reach decisions.
political tactics for using power these include building coalitions, expanding networks, assigning loyal people to key positions, using reciprocity, enhancing legitimacy and expertise, and making a direct appeal.
pooled interdependence the lowest form of interdependence among departments, in which work does not flow between units.
population a set of organizations engaged in similar activities with similar patterns of resource utilization and outcomes.
population-ecology perspective focuses on organizational diversity and adaptation within a population of organizations.
power the ability of one person (or department) to influence other people (or departments) to carry out orders or to do something they would not otherwise have done.
power sources the five sources of horizontal power in organizations are dependency, financial resources,

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centrality, nonsubstitutability, and the ability to cope with uncertainty.

problem consensus the level of agreement among managers about the nature of a problem or opportunity and about which goals and outcomes to pursue.

problem identification the decision-making stage during which information about environmental and organizational conditions is monitored to determine if performance is satisfactory and to diagnose the cause of shortcomings.

problem solution the decision-making stage during which alternative courses of action are considered and one alternative is selected and implemented.

problemistic search search that occurs when managers look around the immediate environment for a solution to quickly resolve a problem.

product and service innovations pertain to the product or service outputs of an organization.

product matrix type of matrix structure in which the project or product managers have primary authority and functional managers simply assign technical personnel to projects and provide advisory expertise as needed.

professionalism the length of formal training and experience of employees.

programmed decisions repetitive and well defined, these decisions are used when procedures exist for resolving the problem.

prospect theory theory that suggests that the threat of a loss has a greater impact on a decision than the possibility of an equivalent gain.

prospector a business strategy of innovating, taking risks, seeking out new opportunities, and growing.

Q

quasirationality a decision-making trend that involves a combination of intuitive and analytical thought.

R

rational approach decision-making process based on systematic analysis of a problem followed by choice and implementation in a logical sequence.

rational goal emphasis represents management values of structural control and external focus.

rational model a model of organization characterized by rational decision processes, clear goals and choices, centralized power and control, an efficiency orientation, and little conflict among groups.

rational–legal authority is based on employees' belief in the legality of rules and the right of those elevated to positions of authority to issue commands.

reactor a response to environmental threats and opportunities in an ad hoc fashion.

reciprocal interdependence the highest level of interdependence, in which the output of operation A is the input to operation B, and the output of operation B is the input back again to operation A.

relational coordination refers to frequent, timely, problem-solving communication carried out through relationships of shared goals, shared knowledge, and mutual respect.

resource dependence a situation in which organizations depend on the environment but strive to acquire control over resources to minimize their dependence.

resource-based approach assesses organizational effectiveness based on how successfully the organization obtains and manages valued resources.

resource-dependence theory describes rational ways organizations try to minimize their dependence on other organizations and influence the environment to make resources available.

retention the preservation and institutionalization of selected organizational forms.

reverse innovation creating innovative, low-cost products or services for emerging markets then quickly and inexpensively repackaging them for sale in developed countries.

rites and ceremonies the elaborate, planned activities that make up a special event and are often conducted for the benefit of an audience.

role a part in a dynamic social system that allows an employee to use his or her discretion and ability to achieve an outcome or meet a goal.

routine technologies are characterized by little task variety and the use of objective, computational procedures.

rule of law that which arises from a set of codified principles and regulations that describe how people are required to act, that are generally accepted in society, and that are enforceable in the courts.

S

satisficing the acceptance of a satisfactory rather than a maximum level of performance, enabling an organization to achieve several goals simultaneously.

sayings mottoes or mantras that encapsulate key cultural values.

scenario planning involves looking at current trends and discontinuities and visualizing future possibilities.

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scientific management emphasizes scientifically determined jobs and management practices as the way to improve efficiency and labor productivity.
sectors subdivisions of the external environment that contain similar elements.
selection the process by which a new organizational form is suited to the environment and can survive, or is "selected out" and fails.
sequential interdependence a serial form of interdependence with parts produced in one department becoming inputs to another department.
service technology is characterized by simultaneous production and consumption, customized output, customer participation, intangible output, and being labor intensive.
skunkworks a separate, small, informal, highly autonomous, and often secretive group that focuses on breakthrough ideas for the business.
small-batch production a manufacturing process that relies heavily on the human operator and is not highly mechanized.
smart factories link manufacturing components that previously stood alone and are also referred to as digital factories, computer-integrated manufacturing, flexible manufacturing systems, advanced manufacturing technology, or agile manufacturing.
social capital the quality of interactions among people and the degree to which they share a common perspective.
social construct created and defined by an individual or group rather than existing independently in the external world.
social network analysis a valuable technique enabled by IT, which can help managers learn about informal relationships and networks within an organization.
sources of intergroup conflict factors that generate conflict, including goal incompatibility, differentiation, task interdependence, and limited resources.
specialist an organization that provides a narrower range of goods or services or that serves a narrower market.
stakeholder any group within or outside of an organization that has a stake in the organization's performance.
stakeholder approach integrates diverse organizational activities by looking at various organizational stakeholders and what they want from the organization.
stakeholder mapping provides a systematic way to identify the expectations, needs, importance, and relative power of various stakeholders and helps managers identify or prioritize the key stakeholders related to a specific issue or project.
standardization policies that ensure all branches of the company at all locations operate in the same way.
stories narratives based on true events that are frequently shared among employees and told to new employees to inform them about an organization.
strategic alliance an alliance that is less formal and binding than a joint venture.
strategic constituents approach an approach that measures effectiveness by focusing on the satisfaction of key stakeholders, those who are critical to the organization's ability to survive and thrive.
strategic contingencies events and activities both inside and outside an organization that are essential for attaining organizational goals.
strategic intent means that all the organization's energies and resources are directed toward a focused, unifying, and compelling overall goal.
strategy a plan for interacting with the competitive environment to achieve organizational goals.
strategy and structure innovations pertain to the administrative domain in an organization.
strategy map a visual representation of the key drivers of an organization's success that shows how specific outcomes in each area are linked.
structural dimensions provide labels to describe the internal characteristics of an organization and create a basis for measuring and comparing organizations.
structure a value dimension that pertains to organization structure and whether stability or flexibility is the dominant structural consideration.
struggle for existence the concept that organizations and populations of organizations are engaged in a competitive struggle over resources, and each organizational form is fighting to survive.
subcultures cultures that develop to reflect the common problems, goals, and experiences that members of a team, department, or other unit share.
sustainability the ability to generate wealth without compromising social stewardship or responsibility for the environment, enabling the organization to meet the current and future needs of stakeholders while preserving the environment and society so that future generations can meet their needs as well.
switching structures an organization creates an organic structure when such a structure is needed for the initiation of new ideas and reverts to a more mechanistic structure to implement the ideas.
SWOT analysis a careful assessment of the strengths, weaknesses, opportunities, and threats that affect organizational performance.
symbol something that represents another thing.
symptoms of structural deficiency signs that the organization structure is out of alignment, including absence of collaboration among units,

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delayed or poor quality decision making, failure to respond innovatively to environmental changes, a decline in employee performance, and the failure to meet goals.

T

tacit knowledge knowledge based on personal experience, rules of thumb, intuition, and judgment that is difficult to communicate and pass on to others.

tactics for enhancing collaboration these include techniques such as integration devices, confrontation and negotiation, intergroup consultation, member rotation, and shared mission and superordinate goals that enable groups to overcome differences and work together.

tactics for increasing power these include entering areas of high uncertainty, creating dependencies, providing scarce resources, and satisfying strategic contingencies.

task a narrowly defined piece of work assigned to a person.

task environment sectors with which the organization interacts directly and that have a direct impact on the organization's ability to achieve its goals.

task force a temporary committee composed of representatives from each organizational unit affected by a problem.

team building activities that promote the idea that people who work together can work as a team.

technical complexity the extent of mechanization of the manufacturing process.

technical knowledge the understanding and agreement about how to solve problems and reach organizational goals.

technology the work processes, techniques, machines, and actions used to transform organizational inputs (materials, information, ideas) into outputs (products and services).

technology innovations changes in an organization's production process, including its knowledge and skill base, that enable distinctive competence.

trade associations groups that allow organizations in the same industry to meet, share information, and monitor one another's activities.

traditional authority is based on a belief in traditions and in the legitimacy of the status of people exercising authority through those traditions.

transaction processing systems systems that automate the organization's routine, day-to-day business transactions.

transnational model a form of organization that has multiple centers, subsidiary managers who initiate strategy and innovations for the company as a whole, and unity and coordination achieved through shared vision and values.

triple bottom line refers to measuring an organization's social performance, its environmental performance, and its financial performance, sometimes called the *three Ps*: People, Planet, and Profit.

U

uncertainty condition that exists when decision makers do not have sufficient information about environmental factors, and they have a difficult time predicting external changes.

V

variation the appearance of new, diverse forms in a population of organizations.

variety in terms of tasks, the frequency of unexpected and novel events that occur in the conversion process.

venture teams a technique used to foster creativity within organizations by setting up small teams as their own companies to pursue innovations.

vertical information system a strategy for increasing vertical information capacity.

vertical linkages are used to coordinate activities between the top and bottom of an organization and are designed primarily for control of the organization.

virtual network grouping with this grouping, the organization is a loosely connected cluster of separate components that are electronically connected for the sharing of information and completion of tasks.

virtual network structure the firm subcontracts many or most of its major processes to separate companies and coordinates their activities from a small headquarters organization; sometimes called a *modular structure*.

virtual team a team made up of organizationally or geographically dispersed members who are linked primarily through advanced information and communications technologies.

W

whistle-blowing employee disclosure of illegal, immoral, or illegitimate practices on the part of the organization.

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